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Brand in Mergers and Acquisitions

An analysis of South African due diligence

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ABSTRACT

This study explores the extent to which brand features in the due diligence process preceding mergers and acquisitions. Current literature suggests that when brand elements are integrated efficiently, success levels of the merge improve. Brand is considered broadly with the focus on corporate branding and therefore incorporates elements of imagery, reputation, culture, employees and external stakeholders.

Brand equity, which comprises the assets and liabilities of the brand is seen as a source of competitive advantage. As such brand is a critical element which could certainly be incorporated formally into the pre-deal due diligence process.

The research questions are to:

- Investigate and explore to what extent the concept of brand is considered in M&A due diligence in the South African context.
- Evaluate and explain the differing roles that the selected corporate advisors put forward in the M&A market regarding brand in South Africa.
- Investigate how M&A practitioners are operating in terms of IFRS 3 legislation which requires transparency in disclosure of intangible assets following a merge.

The findings reveal that corporate advisors generally do not incorporate brand elements in the due diligence process. Their focus remains predominantly financial in assessing the cash-flows implicit of the brand in their analysis.



A typology of the s

rs is developed in terms

of their approach to M&A consulting.

Reporting in terms of intangible assets required by IFRS 3 convention is investigated and the findings confirm that transparency of valuation is not adequately revealed.

Recommendations to the stakeholders involved in M&A include the incorporation of a formal marketing due diligence process to improve disclosure levels, to gain a deeper insight into marketing drivers of cash-flow, to gain a better understanding of inherent marketing risks and to improve valuation practice.



DECLARATION

I declare that this research project is my own, unaided work. It is submitted in partial fulfilment of the requirements of the degree of Master of Business Administration for the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other university.

Date: 14 November 2007

Author: Carl Bezuidenhout



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LIST OF ABBREVIATIONS

BBBEE = Broad based black economic empowerment

BEE = Black Economic Empowerment

DD = Due diligence.

DDR = Due diligence review

E&Y = Ernst and Young Corporate Finance.

IASB = International Accounting Standards Board.

ICBS = Industrial and Commercial Bank of China.

IFRS = International Financial Reporting Standards.

M&A = Mergers and Acquisitions, or the singular - Merger and Acquisition.

S&P 500 = Standard and Poors top 500 companies index

SEC = Securities Exchange Commission



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Chapter 1. INTRODUCTION TO THE RESEARCH PROBLEM.

1.1 DESCRIPTION OF THE PROBLEM AND BACKGROUND.

Why do companies consider mergers and acquisition, especially when conventional wisdom would have us believe that only 20% succeed? (McGrady, 2005; Homburg and Bucerius, 2005 and Gregory, 2006). In an ever changing commercial environment; strategy integration, operational alignment and cultural differences are complicated enough to manage in one business. However when two businesses fuse, the business challenges are exaggerated.

When companies consider mergers and acquisition (M&A) as one of their strategies to improve performance they are after immediate growth, as opposed to incremental and organic growth. Most importantly, they are after skills and assets that cannot be easily replicated. (Aaker, 1991). According to Mahajan, Vithala and Rajendra (1994) motivation for M&A is:

- To enhance performance by increasing market share;
- To develop brand extension and longevity by leveraging loyal customer bases and extracting some form of price premium;
- To develop carryover potential in terms of extending the successful brands through new products or new markets.

Swystum (2001) confirms that a merger is a set of promises created to capture new value not present prior to the transaction. By design, a brand is also a promise and one of the most valuable intangible assets that firms have (Keller, 2004).



Considering “any firm can be conceptualised as a collection of individual brands in markets” (Mahajan *et al.*, 1994 p. 222) it follows, that the due diligence process completed before M&A should address the brand in detail. Academic research confirms the brand matters are indeed the differentiators between success and failure following M&A and that buyers should pay greater attention to marketing and brand issues (Ettenson and Knowles, 2007; Homburg and Bucerius, 2005; Balmer and Dinnie, 1999).

The problem that this research document addresses is that brand in its various forms as brand equity, product labels and even people culture does not appear to be considered in too much detail before the merger by corporate advisors. The due diligence process which could illuminate its value is flawed. (Gould, 1998; Clemente and Greenspan, 1996)

1.2 PURPOSE OF THE STUDY.

The purpose of the research is threefold:

- Firstly, to investigate the extent to which brand decisions are engaged in M&A during the due diligence process by leading South African corporate advisors.
- Secondly, to examine the different approaches of corporate advisors with regard to brand within the M&A context.
- Finally, to consider the reporting and impact of IFRS 3 which is designed to ensure improved transparency levels of intangible in M&A accounting

It is expected that South Africa will not be unique in its approach, as recognized in the literature review, when compared to international practice.



Chapter 2. LITERATURE REVIEW.

2.3 INTRODUCTION.

To gain a deep understanding of the extent to which brand decisions are taken in the M&A process this literature review is presented in three key sections as follows:

- Firstly, **brands** have been researched in terms of brand definition; brand identity; brand equity; intangible assets and marketing assets to give a full picture of current brand thinking and of their impact on shareholder value.
- Secondly the **M&A due diligence process** is investigated, focussing on a general due diligence format and marketing due diligence approach which begins to highlight where brands might feature in M&A.
- Finally, **brands within the M&A context** have been explored to show the value and more importantly failure of not assessing brand during M&A.

2.4 BRANDS.

Aaker (1991) confirms a product can be copied, but brand is unique and timeless.

There is proof of branding in evidence of bricks being branded to identify their maker; of trademarks in ancient Medieval Europe to provide legal protection to consumers and in fine arts branding began with artists signing their own original works (Aaker, 1991; Kotler and Keller, 2006).



Today branding has depth, moving beyond commodity identification it has become the means to stress differentiation, to developing a lasting, unique and distinguishing character and to counter competitor activity. “Today, brands enhance the financial value of firms” (Kotler and Keller, 2006, p. 274; Aaker 1991).

One approach to introducing this strategic orientation is to shift management emphasis of short-term financials to the development of assets and skills (Aaker 1991). An asset is something a company possesses such as a brand name or retail location, whereas a skill is something a firm does better than its competitors (Aaker 1991). Assets and skills provide the basis of sustainable competitive advantage. In other words, what a firm does in the way it competes and where it chooses to do so is easily imitated. It is more difficult to respond to what a business is, since that requires acquiring or “neutralising specialised skills and assets” (Aaker 1991, p. 13). In fact, the acquisition of these distinguishing assets and skills is the motivation behind M&A (Balmer and Dinnie, 1999; Ettenson and Knowles, 2006).

2.4.1 BRAND DEFINITION.

At its basic level Aaker (1991, p. 7) defines a brand as a “distinguishing name or symbol (such as a logo, trademark, or package design) intended to identify the goods or services of sellers, and to differentiate those goods and services from those of competitors.” It signals the source of the product to the consumer and protects both customer and producer from competitors who attempt to replicate the product and pass its features off as their own. (Aaker 1991).



Balmer and Gray (2003) confirm there are a number of schools relating to corporate branding with brands being seen as:

- Marks denoting ownership
- Image building devices
- Symbols associated with key values
- Means by which to construct individual identities
- A conduit by which pleasurable experiences may be consumed

“Brands reflect the complete experience that customers have with products” (Keller and Lehmann, 2004, p. 1) to generate and sustain financial performance (Haigh and Knowles 2004) resulting in brands being visible at three levels, including customer, product and financial markets (Keller and Lehmann, 2004).

Haigh and Knowles (2004) suggest brands provide the only basis for establishing meaningful differences between competing offers and can encompass everything from simple logos and trademarks to the creation of a brand focussed company culture. The creation of “competitive superiority” (Keller and Lehmann, 2004, p. 2) is achieved through leveraging all brand channels.

The role of brands, particularly in the service sector, has changed significantly due to global trends such as deregulation of industries, privatisation of public corporations, the creation of service profit centres independent from the parent, the use of franchising agreements and the removal of world wide trade barriers (McDonald, de Chartony and Harris, 2001).



As opposed to consumer goods firms, service companies must decide whether or not to build the brand on specific product characteristics or the corporate identity. Corporate identity encapsulates “a company’s ethos aims and values and presents a sense of individuality that can help to differentiate the organisation within its competitive environment” (McDonald *et al*, 2001, p. 335 who quotes Balmer, 1998, p. 985).

A change in corporate branding during M&A will therefore affect any and all of these elements and consequently impact the differentiating competitive position of the firm, lowering awareness following a merger (Clayton, 1998 – cited by McDonald *et al*, 2001). For a new name to be launched, the old name must be abandoned which may result in years of branding awareness being destroyed (Muzellec and Lambkin, 2006).

2.4.2 CORPORATE BRAND.

Balmer and Gray (2003) confirm that corporate branding and corporate identity as terms are often used interchangeably and that the association at an industry level is often connected with the graphic design elements of a brand. It is important to clarify here that this thesis is not concerned with the visual elements entirely, but rather with the strategic intent behind corporate branding and brand identity.

Integrated corporate communication and organisational behaviour are strategic elements which comprise the corporate brand (Van Riel and Balmer, 1997).

Companies are constantly tinkering with the brand message and design to keep it fresh and relevant, and to reinforce consideration for purchase. (Muzellec and Lambkin, 2006; Keller, 1993).

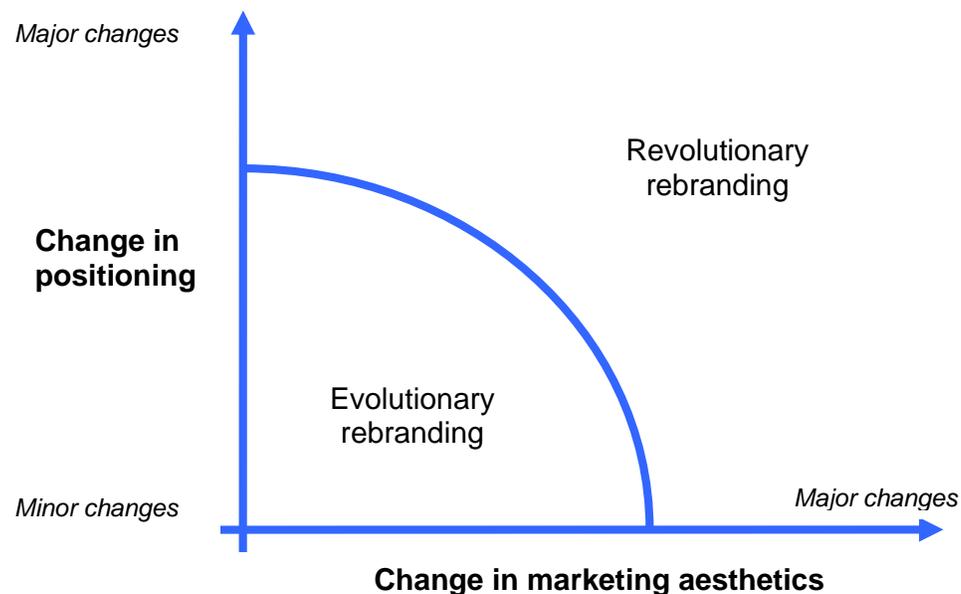
Types of brand changes may be considered as either evolutionary or revolutionary dependant on the degree of change made in brand positioning and in marketing aesthetics as per figure 1 below (Muzellec and Lambkin, 2006).

Evolutionary rebranding describes a fairly minor development that is gradual and less perceivable to outsiders, whereas revolutionary rebranding describes a major identifiable change as often occurs following M&A.

To place research objectives into context the focus is on revolutionary brand changes and the following model provided by Muzellec and Lambkin (2006) is provided to illustrate the differing perspectives.

Figure 1 - Rebranding as a continuum.

Adapted from Muzellec and Lambkin (2006).





The focus within this research is on corporate brands and not product brands and the distinction is articulated by Balmer and Grey (2003) who confirm:

- Corporate brands are different from product brands in terms of disciplinary scope and management. For example the corporate brand attracts involvement of the CEO and product brands are often focused on at brand management level.
- Corporate brands have a multi-stakeholder orientation, while product brands are focussed primarily on customers; and
- Corporate brands do not comply with a traditional marketing framework and therefore require significant new approaches.

Corporate brands are often change following M&A and therefore the strategic intent, closely related to the constituents of a corporate brand should be incorporated into the due diligence process for the firms to retain their enduring advantage post-merger. At worst, simple identity of the characteristics and not valuation could be conducted. Balmer and Gray (2003) provide a structure of these constituents in terms of corporate brands as in the table 1 below.

Confirmed by Muzellec and Lambkin (2006) and Balmer and Gray (2003) the corporate brand has depth and is much more than the imagery of a business. In addition the “heritage of the employees” (Schultz, 2001 p. 9) should be factored into defining a brand after a merger. These authors confirm that both organisation culture and structure influence reputation and image and therefore are crucial components which should be factored into the pre-M&A discussions to gain maximum strategic impact.



Table 1 - Characteristics of corporate brands.

Adapted from Balmer and Gray (2003).

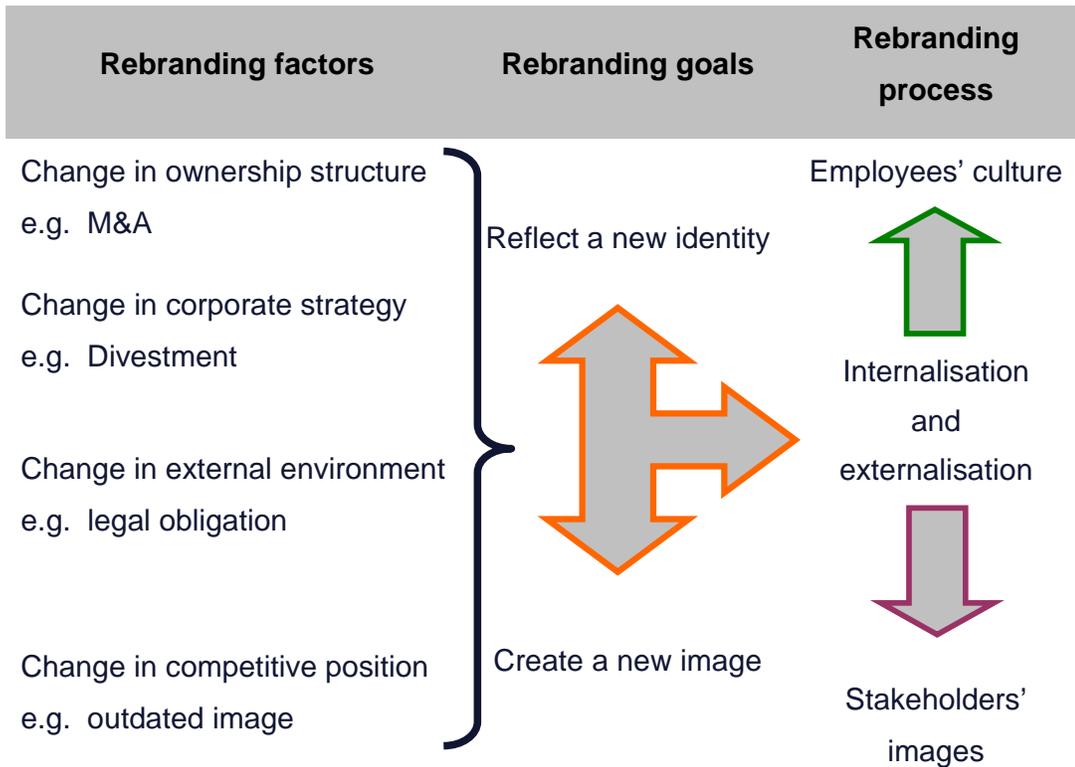
Characteristic	Description
Cultural	Corporate brands have strong “culture roots” and its distinctiveness invariably is manifest in a mix of sub-cultures found in the organisation
Intricate	Corporate brands impact many stakeholder groups and is made known via multiple channels of communication
Tangible	Includes product and service quality, business scope, geographic coverage, performance related issues such as profit margins and pay scales. It also includes architecture in terms of logo's
Ethereal	Includes elements such as lifestyle and style of delivery and therefore encompasses brand associations such as emotional responses.
Commitment (from personnel)	Corporate branding requires commitment from all personnel and therefore communication to and from all stakeholder groups is a vital component

Corporate brands may be viewed as a contractual relationship although it may be unwritten with key stakeholders “to create symbols of comfort and assurance”. (Balmer and Gray, 2003, p. 979).

To emphasise the depth and level of a change in brand, a model of the rebranding process is provided by Muzellec and Lambkin (2006) as follows:

Figure 2 - A model of the rebranding process.

Adapted from Muzellec and Lambkin (2006).



2.4.3 RESEARCH BRAND DEFINITION.

For the purposes of this research, brand is considered as the corporate brand which is not restricted to the organisation as it has “value and durability”. (Balmer and Gray, 2003, p. 985). The importance of staff and corporate culture begin to filter into the role of a corporate brand. The corporate characteristics described in Table 1 confirm that the corporate brand is not just about the company name or iconography. It has depth and consequence in creating competitive advantage (Aaker, 1991; Keller, 1993). The approach of this work is to evaluate the corporate brand in the M&A environment.



2.4.4 BRAND EQUITY.

“Brand equity is a set of brand assets and liabilities linked to a brand, its name and symbol that add to or subtract from the value provided by a product or service to a firm and its customers” (Aaker, 1991, p. 15). It is the added value endowed to products and services, reflected in how consumers behave towards the brand (Kotler and Keller, 2006)

The brand name could be worth a substantial amount, exceeding tangible assets as in table 2 below:

Table 2 – The world’s top brands in 2007.

Source: Sunday Times, 29 July 2007, by Adele Shevel.

Rank	Company	Brand value (R – Billion)	% change on 2006
1	Coca-Cola	65.3	-3%
2	Microsoft	58.7	3%
3	IBM	57.0	2%
4	GE	51.5	5%
5	Nokia	33.6	12%
6	Toyota	32.0	15%
7	Intel	30.9	-4%
8	McDonalds	29.3	7%
9	Disney	29.2	5%
10	Mercedes-Benz	23.5	8%

According to Ambler (2003) brand equity is the distinction between marketing and selling and may be visualised as the reservoir behind a dam. It is always there and should always be topped up so it cannot be left to dry out.



For the assets to generate brand equity they must be linked to the name or symbol of the brand (Aaker 1991) and therefore if the name changes following M&A some or all of the assets could be affected or even lost. The valuation of brand is often subjective, for example in 2002 the Coca Cola brand was valued by AC Nielsen at \$15 billion and by Interbrand at \$69 Billion. (Balmer and Dinnie, 2003 who cite Schmidt and Ludlow, 2002, p. 2)

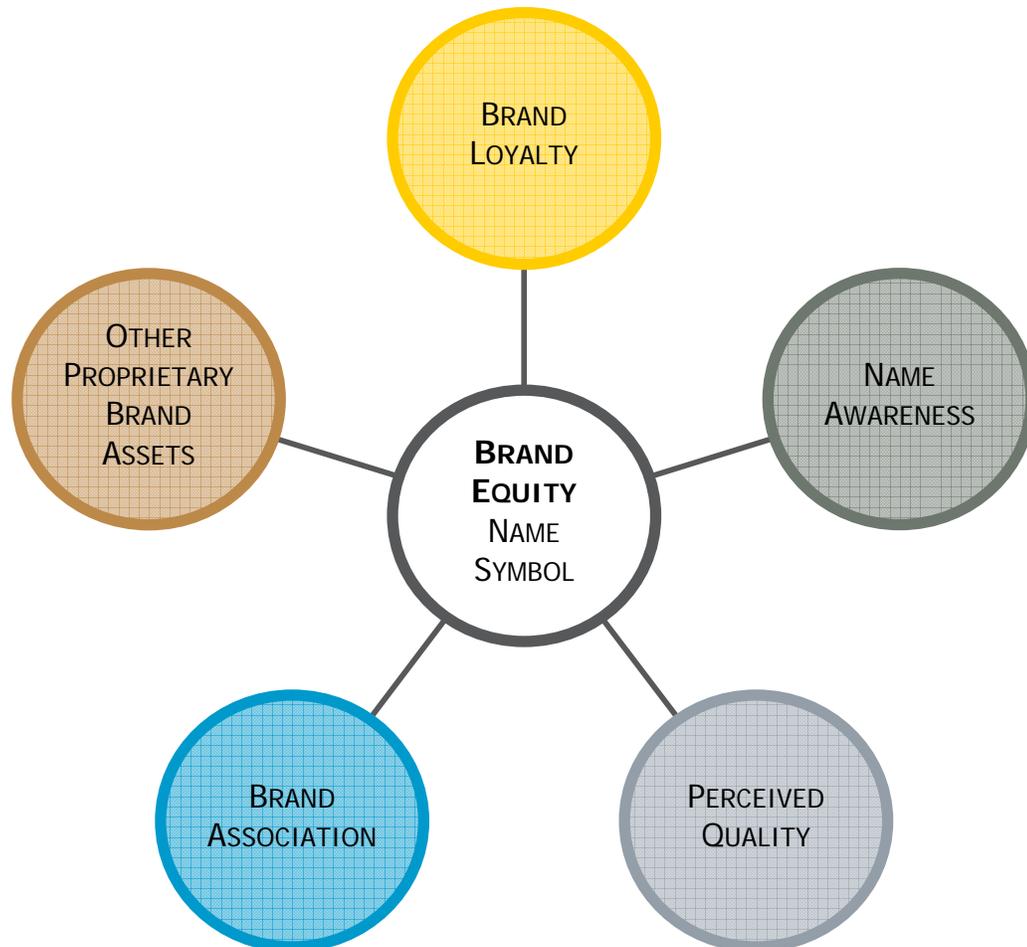
Keller (1993) provides a customer-based brand equity approach, whereby brand knowledge (and its components of brand-awareness and brand-image) is directly related to the value of brand equity. The point is that if this identity changes all the elements and values of brand equity are affected.

Similarly, Aaker (1991) suggests the assets and liabilities on which brand equity is based can be grouped into five categories as follows (as per figure 3):

- Brand loyalty
- Name awareness
- Perceived quality
- Brand association in addition to perceived quality
- Other proprietary brand assets such as patents, trademarks or channel relationships.

Figure 3 - Brand equity components.

Adapted from Aaker (1991).



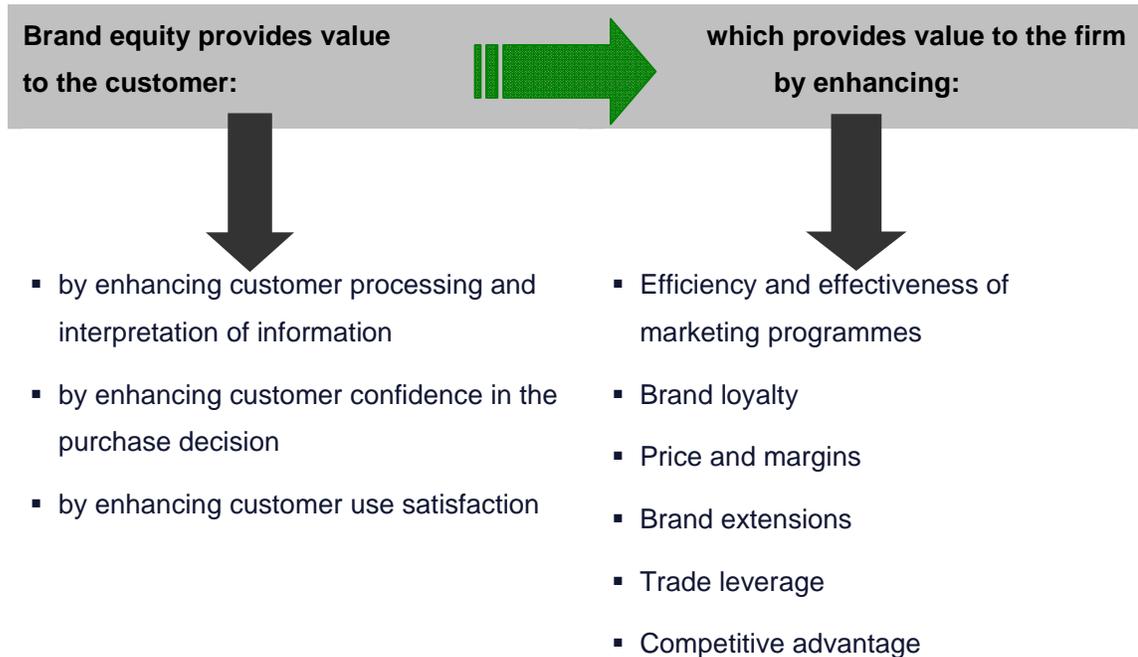
See Appendix A for detailed elements of these components.

Due to the fact that these elements are intangible, and reside in the minds of the consumer (Ambler, 2003) brand equity cannot be measured directly. Therefore, it is certainly a great task to incorporate these elements into any meaningful due diligence assessment, which is possibly why it is not fully assessed and will be tested in the research which follows this review.

Aaker (1991) confirms that brand equity creates value for the firm as it enhances competitive advantage as per table 3 below:

Table 3 - Brand equity creates competitive advantage.

Adapted from Aaker (1991).



In this model increased brand equity is equivalent to competitive advantage. Therefore a change in the elements comprising brand equity will affect competitive advantage.

Corporate rebranding carries a high level of reputation risk, is costly to maintain and it requires careful planning (Muzellec and Lambkin, 2006; Daly and Moloney). Changing the brand name reverses years of effort which can damage or destroy equity in the brand (Muzellec and Lambkin, 2006).



All companies have brand equity and Simon and Sullivan (1993) present a financial market based technique for estimating a firm's brand equity. The calculated value of this intangible asset may vary significantly (or may even be negative) but it will always be present, which means that it is always at stake following M&A.

It is not within the scope of this research to determine the changing financial values of brand equity following a merger although such a study would prove insightful for future researches as it so very closely linked to competitive advantage shown above.



2.4.5 MARKETING ASSETS AND INTANGIBLE ASSETS.

An intangible asset is defined as: “An asset that is not solid, such as a brand name, goodwill or patent as opposed to a tangible asset such as a building or machine which can be touched” (Who Owns Whom (Pty) Ltd, 2006, p. 1104).

There are 89 intangible assets and intellectual properties noted by the International Accounting Standards Board (IASB) attached as Appendix D (Gobel and Forbes, 2006). “Intangible resources range from the intellectual property rights of patents, trademarks, copyright and registered design; through contracts; trade secrets; public knowledge such as scientific works; to the people dependant, or subjective resources of know-how; networks; organisational culture, and the reputation of product and company” (Hall, 1992, p. 135 confirmed by Smith (2002), and Sullivan and Sullivan (2000).

Intangible assets, like brands, account for the bulk of corporate value (Smith, 2002), but are “still sadly neglected in the planning of many M&A’s” (Heberden and Haigh, 2006, p. 37). “With intangible assets representing close to 80% of the value of the Standard and Poors 500, its vital for the due diligence process to include a comprehensive analysis of intangibles that encompass relational assets such as brands” (Ettenson and Knowles, 2006 p. 40).

The growth in intangibles is due to intensified business competition (Sullivan and Sullivan, 2000) created by globalisation, deregulation and the increase in information technology through the internet (McDonald and de Chartony, 2001, Smith, 2002). Sometimes the term brand is used to describe trademark and related marketing intangibles. (Heberden and Haigh, 2006).



“From a business perspective marketing has two functions: To increase the short-term cash flows of the business and to create and nurture a long-lived asset in the form of a brand” (Knowles, 2005). Recent changes in financial accounting standards have given significant attention to the notion of brands as financial assets and therefore the ability to record the value within the formal financial statements of the firm.

In practice however the value is not well documented. Grobel and Forbes (2006) and Forbes (2007) of Intangible Business Ltd, the world’s largest brand valuation consultancy, investigated how FTSE 100 companies account for the £40 billion worth of acquisitions occurring through 2006 and concluded:

- Inadequate reporting of intangible assets – which only accounted for 30% of acquisition value.
- Goodwill is too high – as it accounts for 53% of all value. “£21 billion is dumped into goodwill and unexplained” (Grobel and Forbes, 2006, p. 5)
- Failure to explain goodwill – IFRS 3 requires goodwill to be reduced and described, which did not occur.
- No insights given to investors – as shareholders are uninformed of acquisition constitution.
- Wasted costs – an estimated £80 million in costs incurred in attempts to comply with IFRS 3.

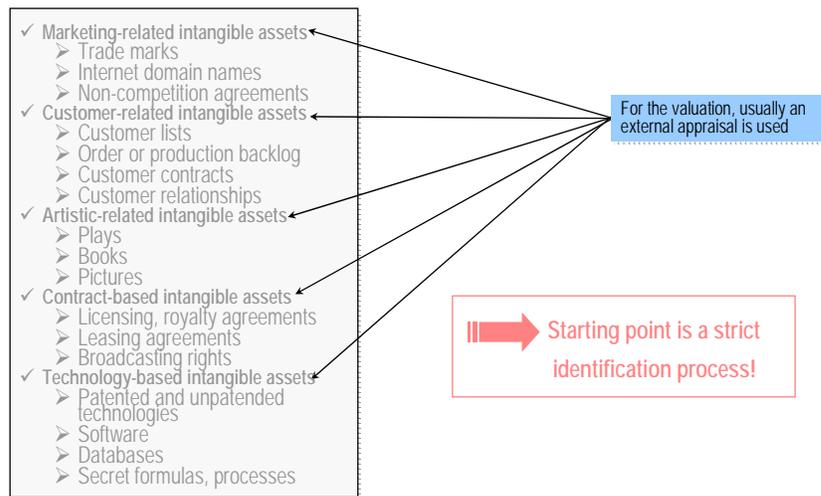
Sinclair (2007) analysed annual financial statements in terms of IFRS3 of companies on the Johannesburg Securities Exchange involved in substantial M&A activity and confirms South African reporting is equally disappointing with “goodwill presented in all its meaningless glory” (Sinclair, 2007, p. 1)

Mr Dave Thayser of Ernst and Young South Africa (post interview by email, 10/07/2007) provides a summary of the International Financial Reporting Standards Schedule 3 (IFRS 3) treatment of brands and other marketing assets, as per figure 4 below. In addition Appendix D is provided as a comprehensive list of intangible assets.

**Figure 4 - Identification of intangible assets regarding IFRS.
Supplied by Mr Dave Thayser (Ernst and Young South Africa).**

Identification of Intangible Assets

Examples of Intangible Assets to be Valued Separately



Knowles (2005) describes the accounting treatment according to IFRS 3 which suggest that intangible value (the amount by which a company's market value exceeds the value of its net assets) can be classified in five categories, namely:

- Technology-based assets
- Contract-based assets
- Artistic assets
- Customer-based assets
- Marketing related assets

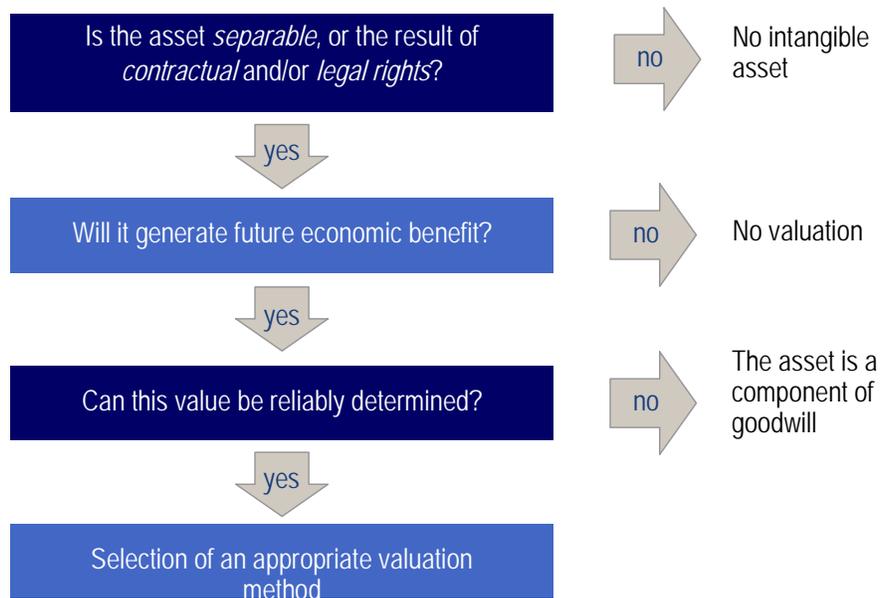


From a financial perspective guidelines are given for the recognition of intangible assets as follows:

Figure 5 - Recognition criteria for intangible assets - IFRS3.

Supplied by Mr Dave Thayser of Ernst and Young South Africa.

Recognition Criteria



The concept of an asset as a generator of a profit stream is very familiar, especially when the asset is capitalised and appears on the balance sheet” (Aaker 1991, p. 14). The most important assets of a firm, such as the people in the organisation and the brand names are intangible in that they have not been capitalised and thus do not appear on the balance sheet (Aaker 1991).

It is anticipated, due to implementation of IFRS (3) as discussed above, that the measurement and incorporation of intangibles through M&A will improve and stimulate a broader conversation around brand and its impact on shareholder value.



2.5 DUE DILLIGENCE.

“From a legal perspective the purpose of due diligence (DD) is to make a good faith effort, within the limits of time and funding, and in consideration of what matters most – the long term financial health of the surviving customers”, to verify the position of the target company being acquired (Lajoux, 2007). McGrady (2005) confirms the dictionary definition of diligence in terms such as “careful”, “persistent”, “earnest”, “painstaking” and the opposite of negligence. Numerous definitions exist (see Appendix B) and diligence can occur in a number of environments, ranging from human resources, marketing activities to include culture, management and even environmental due diligence.

From an M&A perspective the basic function of DD is to assess the potential risks of a planned transaction by “inquiring into all relevant aspects of the past, present and predictable future of the business to be purchased” to produce a successful outcome (Lajoux, 2007; McGrady, 2005).

According to a research project at the University of Minnesota, due diligence checklists range from 6 to 180 pages and the count of action items ranges from 164 to 1282 with “accounting/ financial” as the most common item (Hubbard, Lofstrom and Tully, 1994). In agreement with McGrady (2005), Hubbard *et al.* (1994) confirms that brand issues such as competitive analysis seem underrepresented on many checklists.



2.5.1 GENERAL DUE DILIGENCE.

Lajoux (2007) suggests the traditional four core areas of due diligence (DD) includes:

- Financial statement review – to evaluate the financial health of the company with regard to its Income Statement and to confirm the existence of assets, liabilities and equity on the Balance Sheet.
- Management and operations review – to determine the quality and reliability of the financial statement and to assess contingencies beyond the term of the statements
- Legal compliance review – to check for future legal problems stemming from the targets past
- Document and transactions review – to ensure the paperwork is in order and the transaction is structured appropriately.

The introduction of “Sarbanes-Oxley will make due diligence easier” as greater responsibility is moved to the directors and officers of the target and therefore higher levels of accountability in presenting the financial statements is expected (Lajoux, 2007, p. 8).

Governance issues, in the wake of Sarbanes-Oxley, IFRS and the King III commission codes will influence DD to such a degree that independent (external) verification will be required in future (Lajoux, 2007). Herein lays the rub. The intangible assets of the target, including brand and various marketing assets described above, can often not be easily defined, measured or verified externally, and therefore are excluded (McGrady, 2005).



Although very adequate, tested guidelines exist to extract best practice and incorporate all elements of analysis in a complete DD exercise, the process is essentially financial, tax and legal in nature (McGrady, 2005,). Following an investigation into significant deals McGrady (2005) confirms “that intangible issues such as culture, leadership and change are critical to success” (McGrady, 2005, p. 8) but that the legal and financial bias of DD fails to incorporate these elements appropriately.

“Tying the results of the pre-deal due diligence directly into the post-deal operating plans for the acquisition candidate seems a very smart way to try to ensure that the DD findings are realistic” (Hubbard *et al.*, 1994, p. 36)

2.5.2 MARKETING DUE DILIGENCE.

Gould (1998) and Clemente and Greenspan (1996) state that traditional due diligence is flawed in that “insufficient attention to key details of marketing infrastructure, strategy and tactics is disclosed – which prevents the companies becoming truly integrated and customer focussed” after the merger (Gould, 1998, p. 25).

The main benefits in M&A come from finding opportunities to enhance competitive advantage (Gould, 1998). Given the brand is the identity of competitive advantage (Aaker, 1991) it is clear that brand issues should be deeply incorporated. “The marketing assets determine the likelihood of achieving the strategic and financial objectives behind the deal proposal” (Gould, 1998, p. 25) and therefore a marketing due diligence process is suggested.



“Current fashionable methods of valuing intangibles, such as brand valuation techniques are fundamentally flawed” (McDonald, Smith and Ward, 2006, p. 28) as they assess the value of intangibles in terms of replacement costs and not in terms of utilisation: value flows from how the asset is utilised. To complement financial due diligence and assess the effectiveness with which assets and resources are applied, a marketing due diligence approach is suggested (Gould, 1998; McDonald *et al.*, 2006).

Strategic marketing consultants are joining investment bankers to bring a fresh perspective to pre-deal M&A (Clemente and Greenspan, 1996) and to enhance strategic fit (Gould, 1998). Some of the elements included are assessments of:

- Overall marketing and sales infrastructures, including people, processes and programs;
- Marketing planning and therefore the ability to achieve goals – which impacts future cash-flows to be generated
- Marketing technology and sales applications, an audit of abilities and projections.

McDonald *et al.* (2006) provides the complete framework of the marketing due diligence process as per table below. “It becomes possible to identify, manage and reduce risk to a practical minimum” (McDonald *et al.*, 2006, p. 45).

Compared to the traditional due diligence process it appears the focus is more future orientated and customer targeted.



Table 4 – Risk assessment in terms marketing due diligence.

Adapted from McDonald, Smith and Ward (2006).

Identified risk	Sub-component of risk identified
<p>Market risk.</p> <p>The risk that the market may not be as big as promised</p>	<ul style="list-style-type: none">▪ Product category risk – higher probability of success if there are well established product categories▪ Segment existence – establishment of target segment▪ Sales Volumes – supported by evidence▪ Forecast growth – in line with historical trends▪ Pricing assumptions – relative to current pricing levels
<p>Share risk.</p> <p>The risk that the strategy may not deliver the market share promised</p>	<ul style="list-style-type: none">▪ Target market risk – higher rate of success if defined in terms of homogenous segments characterised by useful data.▪ Proposition risk – if proposition delivered to each segment is different from that delivered to other segments▪ SWOT alignment – risk that strategy fails if it does not leverage strengths and minimise weaknesses▪ Uniqueness risk – as compared to market competitors▪ Future risk – The risk that strategy will fail due to market needs changing between conception and execution
<p>Profit risk.</p> <p>The risk that the strategy may not deliver the margins promised.</p>	<ul style="list-style-type: none">▪ Profit pool risk – risk that profit will be less than planned▪ Profit sources risk - based on competitors reaction▪ Competitor impact risk – based on impact on competitors▪ Internal gross margin risk – risk that internal gross margins will be less than planned if core cost change▪ Other cost risk – risk on net margins calculated



2.6 BRANDS IN MERGERS AND ACQUISITIONS.

2.6.1 INTRODUCTION.

“**Merger** is defined as the consolidation of two firms that create a new entity in the eyes of the law” (Bruner, Chapter 1, p. 1), which can be the identity of the acquirer or target company or one that is newly developed (Rosson and Brooks, 2004).

An acquisition is simply a purchase. Businesspeople use the terms interchangeably and the acronym M&A denotes both respectively (Bruner, 2005).

2.6.2 M&A MOTIVATION.

“Creating new brands requires huge investment and isn’t guaranteed” (Motameni and Shahrokhi, 1998, p. 289). The deceptively simplistic motivation for M&A is to acquire well known and proven brands at once, to hedge against the high costs and risks of new product development (Mahajan, Vithala and Rajendra, 1994; Swystum, 2001; Thayser, 2005 p. 8).

Acquisition strategy provides firms with the ability to gain access to new markets, amass economies of scale, plug product gaps, expand share of wallet or strengthen their positions in existing markets by choosing tested winners and established brands. (Mahajan, 1994; Preston, 2005; Hogan, Glynn and Bell 2003).



With such a strategy one should reasonably expect that brand integration at all levels should be of utmost priority during all phases of negotiation. “Successful business mergers demand successful brand mergers if they are to succeed” (Basu, 2002, p1) in creating a basis for superior customer value and competitive differentiation for strategic advantage. Communicating what the new company stands for to existing and new customers, staff and suppliers helps mitigate M&A risk (Rosson and Brooks 2004).

The building of a strong and clear corporate identity is critical for merger success (Balmer and Dinnie 1999) as it enhances the likelihood of “bonding” (Van Riel and Balmer, 1995, p. 29) with the brand and identifying with the newly formed organisation. (Machado, Lencaster and Dionisio, 2004; Melewar, 2001; Rosson and Brooks, 2004).

2.6.3 MEASURE OF SUCCESS.

“Mergers worldwide surge to a record \$3.1 trillion”. (Weirdigier and Cimilluca 2006). South Africa is certainly following suit as a rise in private equity and BEE activity lift merger and acquisition (M&A) values by 5,6% from R269 Billion in 2005 to R284 Billion in 2006 (Thayser, ed. 2007).

Demand for entering M&A transactions is high in South Africa with “ample foreign investment targeting resource rich lands” (Harrison, 2007, p. 18). Barclays bank investment in ABSA in 2005 and Standard Banks recent 20% equity sale to Industrial and Commercial Bank of China (ICBS) for R36, 7 Billion is certainly testament to the fact (Stovin-Bradford, 2007).



With such significant sums of money being thrown at this growth strategy it should be highly attractive. The paradox however is that the track record of M&A's has hardly been stellar. "There is 30 years of evidence, that the majority of acquisitions do not create value for acquiring shareholders (McGrady, 2005, p. 18).

Estimated failure rates are typically between 60 and 80% (Homburg and Bucerius 2005). Balmer and Dinnie (1999) confirm 48% of M&A's under perform their industry; Gregory (1999) states that less than half of the mergers completed during the 80's and 90's have created real value for shareholders and Gregory (2006) discusses a McKinsey & Co. report that nearly 80% of mergers don't earn back the costs of the deals themselves. Furthermore, Ettenson and Knowles (2006) suggest that deals end up destroying value instead of creating value for the companies involved.

Rosson and Brooks (2004) confirm that that there are positive gains for acquirers, but for sellers over a three to five year period 50% to 80% of M&A's under performed against comparable companies or destroyed value.

In contrast, Bruner (2005) dismisses the common view of a 20% success rate. In broad terms and on balance he states that M&A rewards shareholders and that on average this view is supported by academic research. He discusses success and its measure for two primary parties: the buyer and seller of the target company.



“Target firms enjoy returns that are materially positive” (Brunner, 2005 Chapter 3 p. 6) however buyers “on aggregate are essentially zero” meaning that these acquisitions tend to offer zero net present values, or equivalently, that investors earn their required return”. (Brunner, 2005, Chapter 3 p. 7).

Where failure does occur, Brunner (2005; Chapter 1 p. 5) describes a “perfect storm of factors that combine to destroy the new firm”. Six factors are mentioned. Of these, 50% are directly related to marketing and brand as follows:

- Impaired strategic position – which includes “loss of market share and abandonment of profitable products” (Brunner, Chapter 1 p. 6);
- Organisational weakness – which includes “transmission of cultures and values” (Brunner, Chapter 1 p.6), often embodied in the corporate brand which clashes with the acquirer;
- Damaged reputation – a change in brand promise, which includes “change in name recognition or poor press coverage” (Brunner Chapter 1 p. 7) negating all value that once may have been associated with the corporate brand.

Poor post merger communication, overvaluing synergy, slow integration pace, poor strategy, payment in stock, overpaying, and incompatible corporate cultures are further reasons given for failure by Rosson and Brooks (2004).



It is further echoed by Balmer and Dinnie (1999) who provide nine reasons why mergers fail. Of these the most relevant brand and marketing issues are:

- Corporate marketing communications are given short-term attention (Balmer and Dinnie, 1999, p. 5). Hogan *et al.* (2003) agrees that long term plans for the merged brands are largely an after thought which affect the organisations ability to achieve its strategic objectives, or may cause overpayment for assets not appropriately employed.
- “Unresolved naming issues can reflect unresolved corporate identity” (Balmer and Dinnie, 1999, p. 2) and therefore monolithic singular visual branding structures are developed without consideration to product identity and consumer engagement.
- Brand specialists in terms of corporate identity and corporate communication consultants are brought in too late to impact perceptions.

2.6.4 WHY SHOULD BRAND BE INCORPORATED?

Marketing issues and brand should be incorporated to improve success rates of M&A; such as improving customer retention, maintaining service quality, retaining or rebuilding customer perceptions of the brand and countering competitor actions. (Homburg and Bucerius 2005 – who cite Beckier and Shelton, 2002; Morall, 1996).

One of the key reasons given for failure is due to ineffective synergy in brand value for the customer (Perry and Herd, 2004) and to improve this position management should consider “redeployment of marketing resources (which) has a significant effect on firm performance after M&A” (Homburg and Bucerius 2005, p. 95).



Unless this is done timeously, the brand value and brand equity originally part of the competitive identity that once existed in the individual companies before the merge, is shattered and mismanaged after the fact (Ettenson and Knowles 2006).

In two-thirds of cases brand strategy is deemed to have a low priority in pre-merger discussions, and therefore this “lack of urgency generates a sub-optimal brand in the final stages of negotiation” (Ettenson and Knowles 2006, p. 40). Where brand equity is rebuilt it is done so at additional expense, negating the synergy and cost reductions sought in the original acquisition.

Risk can be reduced through improved due diligence focussing on marketing assets (Perry and Herd 2004; Mahajan *et al.*, 1994). If managed proactively, the branding decision provides management with the “unique opportunity to develop a compelling vision to signal employees, clients and investors of the combined entity to be formed” (Ettenson and Knowles 2006 pg 40).

Corporate identity transcends disciplinary boundaries (Balmer and Dinnie 1999) and therefore is effective in improving the non-financial aspects of merger activity. In other words implementing a rigorous pre-deal corporate identity process is therapeutic in addressing the creation of a culture identity which is a key to a successful merger.

Ettenson and Knowles (2007) provide three key reasons why marketing and brand should be incorporated in the pre deal phase as follows:



- Selling the brand – how is the merger to be communicated to future and existing customers, staff, investors and suppliers to win their support? A marketing orientation would ensure the corporate brand is chosen on strategy and not expediency.
- Finding key assets – typically the pre-merger discovery limits itself to verifying the potential of hard assets such as property, equipment, patents and drilling rights. A marketer would look at “relational assets that drive cash flow, such as corporate reputation, goodwill and the brand itself – vitally important factors that get overlooked in a merger deal” (Ettenson and Knowles 2007, p. 1)
- Looking beyond deal breakers – whilst the due diligence process is often concerned with “deal breakers” and looking for ways to cut internal costs the marketing orientation would focus on “deal makers” or factors that could enhance success. Homburg and Bucerius (2005, p. 95) agree and state that “cost reduction to make a merger pay-off is not as important as customer retention”

2.6.5 HOW COULD BRAND BE INCORPORATED?

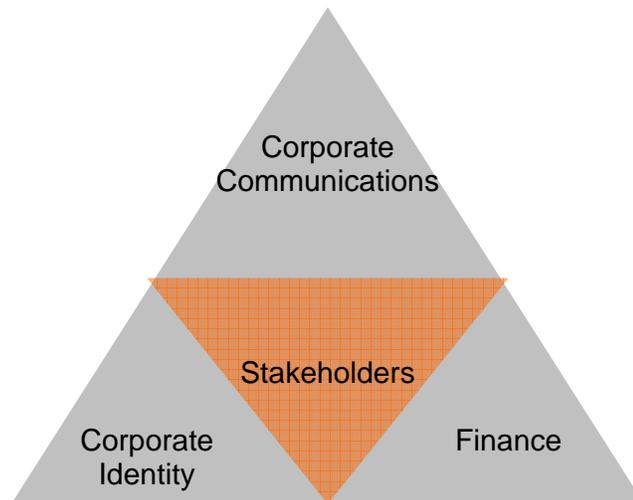
If brand is to be incorporated in M&A the benefits must be tangible. “The tighter the link to the bottom line ... the better” (Kumar and Blomqvist 2004, p. 26), who suggest M&A participants should:

- conduct a marketing due diligence exercise before the deal
- consider brand strategy in the context of a growing portfolio
- establish brand migration plans to help “maximise the brand value in the deal” (Kumar and Blomqvist 2004, p. 21).

Balmer and Dinnie (1999) create a “merger mix” of elements central to the merger management process and state that stakeholders of both merging entities should be considered.

Figure 6 - Merger Mix.

Adapted from Balmer and Dinnie (1999).



In terms of corporate identity, Ettenson and Knowles (2006) and Machado *et al.* (2004) provide alternatives along the following themes for a new name as follows:

- Adopt one brand – “Back the stronger horse”
- Create some combination of two brands – “Best of both”
- Adopt something entirely new – “Different in kind”
- Change nothing – “Business as usual”.

While, Basu (2002) suggests the approach in terms of name and strategy is linked directly to the original deal motivation and could be one of, or a combination of: streamline, rationalise, consolidate or reconfigure the portfolio offering as per table 5 below:



Table 5 - Four approaches to merging brands.

Adapted from Basu (2002).

Approach	Streamline	Rationalise	Consolidate	Reconfigure
Focus on:	Efficiency	Profitability	Market convergence and coherence	Change
Definition	Objective is to develop the most efficient flow using combined resources of merged firm	An extreme form of streamlining. I.e. not simple collapsing of multiple flows into one channel but collapsing brands within the chosen flows as well	Demand or customer driven approach which eliminates overlap of brand portfolio and adds strength to leverage the whole portfolio	Radical change. Means abandoning previous flows and discovering a new way of thinking about the business in terms of its competency and vision. May include new technology and new segmentation



Consideration should also be given to the corporate brand category as described by Balmer and Gray (2003) as follows:

Table 6 – New corporate branding categories
Adapted from Balmer and Gray (2003, p. 984)

New corporate brand category	Explanation	Example
Familial	The sharing or adoption of the same corporate brand by two entities within the same industry or sector	Hilton (UK), Hilton (USA) Shell (UK), Shell (The Netherlands)
Shared	As above, but operating in distinct and sometimes related markets	Rolls Royce (Engineering / Aero engines) (UK) vs. Rolls Royce (former car subsidiary of BMW) Volvo (commercial vehicle) vs. Volvo (car subsidiary of Ford USA)
Surrogate	A franchise arrangement whereby one organisations products are branded as that of another	British Regional Airways – Use of British Airways brand
Supra	A quasi arch brand used to supra endorse company brands. Common in airline sector. Derived from several rather than single corporate entity	“One world” Airline Alliance “Star” Airline Alliance
Multiplex	Multiple use and multiple ownership rights of a corporate brand among a variety of entities in a variety of sectors.	Virgin Virgin Atlantic Airways Virgin Trains Virgin Financial Services
Federal	The creation of a new corporate brand by separate companies who pool their resources in a joint venture to in effect create a new identity and new company.	Airbus Consortium



2.6.6 CONCLUSION OF BRANDS IN M&A.

“We throw a great wedding ... but a poor marriage” (Swystun, 2001 p. 1) who confers with Ettenson and Knowles (2006) that the existing due diligence process is extremely adept at assessing tangible assets but that the softer form of intangibles such as brands, goodwill and reputation need deeper inspection.

“A company needs to take a holistic view of communications because it is communicating all the time to all of its publics. The communication which is taking place, even if unplanned or unconscious is creating impressions, and images are being formed”. (Bernstein, 1986, p118).

Considering a brand is a message this element should be given timely consideration, and if done so at the outset of a transaction the business could enjoy a stronger more sustainable competitive advantage to drive increases in shareholder value (Kumar and Blomqvist 2004).

Building a brand after M&A is without question more challenging than building a brand for a new company and therefore brand elements should be audited before the deal is concluded so that the merging companies can consider whether or not to refine, maintain or recreate brand strategy (Johne 2003).

Empirical evidence produced by Homburg and Bucerius (2005) confirms that when marketing integration occurs quickly after a merger there is stronger impact on financial performance as opposed to cost savings. “The fast integration process can limit customer uncertainty and therefore enhance market performance” (Homburg and Bucerius 2005, p. 107).



The research shows that M&A is on the increase worldwide and that there are varying rates of success from as low as 20%. One of the reasons given for disappointment is failure to incorporate a marketing orientation of brand elements into the pre-deal due diligence activity.

In fact, Kumar and Blomqvist (2004) suggest that at best a marketing due diligence is conducted before the deal; that parties should think about brand strategy and establish brand migration plans of the portfolio. At worst, dialogue and integration of brand elements should be in place to develop a competitive position from the merger that is stronger after the fact.

The fact that brand is not properly being accounted for as an intangible asset (Grobel and Forbes, 2006; Sinclair 2007) in terms of IFRS 3 reporting is possibly evidence that it is not being deliberated in the boardroom before the M&A is consummated.

By design, a brand is a promise and one of the most valuable intangible assets that firms have (Keller, 2004). Swystum (2001) confirms that a merger is also a set of promises created to capture new value not present prior to the transaction.



Chapter 3. RESEARCH QUESTIONS.

3.1 INTRODUCTION.

The research questions were aimed at large organisations who are most often the corporate advisors performing due diligence and providing financial services offerings in M&A; as well as specialists who are involved in brand valuation or brand development before or after the M&A transaction. Therefore the outcome of conversations with these groups would be fundamentally different based on their specialisations and their technical understanding of brand and corporate finance terms. This might have created some bias or error in the findings as discussed in sampling error below.

The literature review does not provide solutions or a structure which could be replicated to the research objectives, particularly not in the South African context; therefore research questions were used to explore the current approach in the South African M&A market. The research questions and the questionnaire were informally tested with Dave Thayser of Ernst and Young before the remaining corporate advisors were interviewed.

The research is of a qualitative nature and therefore subjective and informal (Zikmund, 2003). To provide some guideline however a questionnaire was designed and sent to the respondents before the interview (attached as Appendix F) in order to offer an opportunity to consider content and prepare for the meeting. Open ended questions dominated the conversation to gather insight into M&A activity regarding brand.



In some instances it became clear early on in the conversation that many of the questions were not applicable. If the conversation moved in a new direction, as is the nature of qualitative research, the conversation flow would be followed to its own outcome.

3.2 RESEARCH QUESTIONS.

The research questions were developed to discover 3 issues, namely to:

- Investigate and explore to what extent the concept of brand is considered in M&A due diligence in the South African context.

- Evaluate and explain the differing roles that the selected corporate advisors put forward in the M&A market regarding brand in South Africa.

- Investigate how M&A practitioners are operating in terms of IFRS 3 legislation - which requires that Goodwill be reduced in the purchase consideration and that intangible assets such as brand should be valued to quantify this reduction for transparency or governance benefits to shareholders and investors of the merging firms.



Chapter 4. RESEARCH METHODOLOGY.

4.3 INTRODUCTION

The research objective is to discover the extent to which brand decisions are engaged in the due diligence process by leading South African corporate advisors and therefore qualitative research was conducted with the purpose of investigating, exploring, describing and diagnosing the situation (Zikmund, 2003) in determining the state of brand in M&A..

4.4 PROBLEM DISCOVERY

Following a research assignment completed for the Marketing course in the GIBS MBA, which was done on marketing metrics in June 2006 I discovered an article written by Prof. Roger Sinclair (Sinclair, 2006) describing the brand value accounted for in the ABSA / Barclays merger. The article discusses the ABSA brand and whether or not the value is appropriate in terms of the value itself, and in terms of the accounting standards of IFRS 3.

The problem discussed in the article is that there have been substantial reporting changes regarding Business Combinations which is the accounting term defined by the International Accounting Standards Board (IASB) for the “bringing together of separate entities or businesses into one reporting entity”. Through this legislation it is a requirement in terms of IFRS 3 that the intangible assets are to be individually identified and appropriately valued.



Therefore the motivation for this research was triggered, to discover if brand, as one of the 59 intangible assets (see Appendix D) and possibly a proxy for many of these assets is adequately discovered and accounted for in the due diligence process preceding a merger or acquisition.

Of particular interest is the fact that brand is perceived as a broad and nebulous concept by corporate finance practitioners. Simultaneously, it has delicate intricacies which comprise the brand idea and so the research is aimed at uncovering whether or not the M&A advisors appreciate its depth when assessing its financial value.

4.5 INTERVIEW RESPONDENTS

To achieve the research objectives various corporate advisors were interviewed as follows:

- Specialist M&A role-players were interviewed as listed in Table 7 due to the positions they occupy in structuring the financial requirements of M&A transactions, due diligence reporting, taxation advice, legal counsel and as sponsoring brokers in the M&A environment.
- Specialist brand and strategy role-players were interviewed as listed in Table 8, due to the authority they could bring regarding brand valuation and specialist due diligence approaches.

Informally there may certainly have been more independent advisors involved, but it is not known or recorded in the E&Y database of transactions and this is noted as a limitation in terms of the research.



Table 7 – Corporate M&A advisors interviewed.

Compiled by the author from E&Y database of M&A activity for 2005 and 2006.
The data is sorted alphabetically by corporate advisor

Corporate advisors	Value 2005 (R – Million)	Value 2006 (R – Million)	Total Sum of Value
Bowman Gilfillan	8,210	69,728	77,938
Deloitte	4,963	5,384	10,347
Ernst & Young	7,002	14,964	21,966
Investec Bank	43	32,946	32,989
KPMG	6,025	31,580	37,605
PricewaterhouseCoopers	29,365	23,793	53,158
Grand Total	55,607	178,394	234,002

Table 8 – Brand agencies and strategy advisors interviewed

Brand agencies and strategy advisors interviewed
▪ The Disruption Consultancy – member of TBWA
▪ McKinsey Consulting (this interview was done telephonically)
▪ Brand Metrics
▪ Burlington Corporate Strategy Advisors

Table 9 – Corporate advisors assessed in terms of M&A deal value

Compiled by the author from E&Y database of M&A activity for 2005 and 2006.

All Corporate Advisors	Total Sum of Value (R – Million)	Total Count of transactions
Corporate advisors involved in M&A transactions	439,638	638
No corporate advisors involved in M&A transactions	113,508	1,627
Total M&A transactions for 2005 and 2006	553,146	2,265

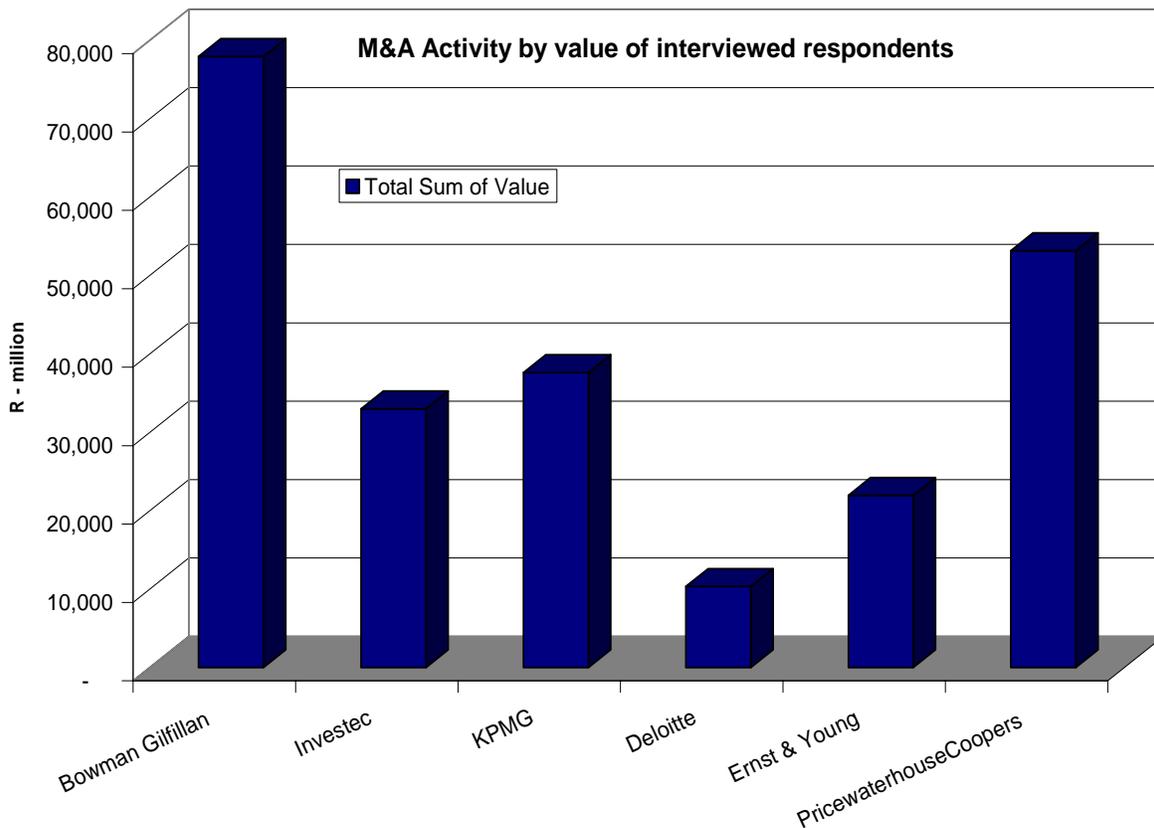


Table 9 shows that 2,265 M&A transactions occurred from 2005 to 2006. It also reflects that of these transactions 1 627 or 72% did not have any formal corporate advisor involved in the transaction. By deduction therefore corporate advisors were involved in 638 transactions to a value of R439, 638 Million.

As can be seen from Table 7, and confirmed in Figure 7 the parties that were interviewed were collectively involved in transactions to the value of R234 Billion. The corporate advisors were selected for interview purposes based on the value of transactions they had been involved in, and this value was subjectively judged to be sufficient to confirm their credibility in the M&A market.

Figure 7 – M&A Value for 2005 and 2006 of interviewed corporate advisors.

Analysed and created by the author from E&Y data for South African M&A transactions from 2005 to 2006. All values are in R – million.





As many of the corporate advisors are often involved in the same transaction due to the specialisations they offer, it is not appropriate to rate the number / value of transactions done by the interviewed respondents against the remaining group as this would unnecessarily count duplicated records.

4.6 RESEARCH TECHNIQUE

Zikmund (2003) confirms that exploratory research is classified as such because of the purpose of the research and not necessarily because of the actual technique utilised. In this regard the purpose of the research is certainly to explore and to determine the degree, if any, to which corporate advisors include brand as one of many intangible assets in their due diligence process and in client advice.

There are four general categories of exploratory research methods which include experience surveys, secondary data analysis, case studies and pilot studies (Zikmund, 2003). Of these four, two research techniques were utilised to gain a complete understanding of the M&A field and to explore the research objective as follows:

- Secondary data was analysed to provide an understanding of M&A activity in terms of value and quantity. The main purpose of this data was to select the key respondents to be interviewed. The secondary data was obtained from Ernst and Young Corporate Finance (E&Y) of all M&A transactions recorded during 2005 and 2006.
- Experience surveys; where knowledgeable individuals of the research problem are surveyed (Zikmund, 2003) were conducted with the identified corporate advisors.



4.7 RESEARCH METHOD

The main research method employed was through surveys (expert interview) with the selected corporate advisors. This took the form of a face-to-face interview, lasting on average 1, 5 hours. Transcripts and audio recording of the interviews were taken with the permission of respondents. The transcripts are attached as Appendix K1 to K10, however the individual names of the respondents have been removed from the transcripts to ensure confidentiality.

4.8 POPULATION

There are two groups comprising the population, namely brand specialists involved in M&A transactions and M&A corporate advisors.

4.8.1 BRAND SPECIALISTS

It is not known how many brand specialist agencies exist in the population in South Africa, nor is this information recorded in any way. According to Koendermann (2006) R20 Billion was spent in South Africa during 2006 on above the line advertising alone. No breakdown is recorded in terms of M&A activity.

Secondly there is no reason why South African companies would only deal with South African brand agencies and therefore the sample could include global firms not specifically recorded in South Africa.



4.8.2 M&A CORPORATE ADVISORS

2005 and 2006 was selected as the sampling years for the secondary data analysis as IFRS was introduced in South Africa with effect 01/012005. There were 92 corporate advisors involved in the 2005 and 2006 M&A activity provided by E&Y.

In terms of the experience surveys the approach was to concentrate on the top corporate advisors in terms of Rand value. Some of the identified respondents were unable to provide interviews in time and so the sample was somewhat reduced.

Normally the head of the corporate finance division was interviewed to ensure a broad approach was given and no one discipline within the corporate finance division was over-emphasised. The interview was generally “quite informal” to allow for conversation and to explore elements that may not have been on the questionnaire or to move beyond issues that were no longer relevant in the context (Zikmund, 2003, p. 114).

4.9 SAMPLING

The target frame is those organisations that have played a strategic role in M&A activity including the large auditing consulting firms, sponsoring brokers and brand advertising agencies. According to the E&Y data for 2005 and 2006 there were 92 corporate advisors and 89 attorney firms associated with the recorded M&A transactions. In many instances more than one advisor and attorney group was involved in the same transaction.



The sampling unit is those specific companies (judgment sampling) identified above with reputable track record and reasonable volume activity in the M&A market of South Africa.

In this regard 6 corporate advisors, collectively involved in R234 Billion worth of M&A activity were selected. Through referrals (snowball sampling) from the corporate advisors 4 highly regarded brand / strategy consultants involved in strategy, brand and valuation appraisals were interviewed.

Of all the M&A transactions recorded in the EY data approximately R113 Billion worth of transactions or 21% did not have corporate advisors involved in the transactions. The remaining R439 Billion had a corporate advisor connected to the transaction and of these transactions the interviewed respondents were collectively involved in R234 Billion of these transactions.

Although a large value of transactions were concluded by the interviewed corporate advisors this does not indicate that the findings are in any way representative of the population. In fact, representatively is not a consideration for such exploratory research (Zikmund, 2003).

A non-probability survey was conducted, based on convenience sampling as the respondents were deliberately picked based on M&A activity and access to information sources. Snowball sampling also occurred in terms of referrals to industry specialists from the initial testing done with Dave Thayser of E&Y. Expert interviews were conducted with the divisional heads of the selected corporate finance advisors.



4.10 COLLECTION OF DATA

The E&Y database was received as an excel table of all M&A transactions occurring in 2005 and 2006, as well as the values, corporate advisors, bankers, brokers and market related comments and statistics of each transaction

The expert interviews were conducted in person with the identified corporate advisors and brand / evaluation specialists. The conversations were recorded and transcripts of the conversations are included herein.

4.11 UNIT OF ANALYSIS

The unit of analysis is the M&A transaction itself.

The underlying aim is to determine whether or not brand, for the value it is supposed to bring as discussed in the literature review, is incorporated in the due diligence process undertaken by corporate advisors.



4.12 SAMPLING ERROR

According to Zikmund (2003) sampling error will likely occur as a result of respondent and administrative errors as follows:

4.12.1 RESPONDENT ERRORS

- Non-response error as one of the selected corporate advisors was unable to participate in the research. This could not be avoided due to personal circumstances of the respondent.
- Telescoping – where those advisors or consultants interviewed recall most recent events first. To reduce this error the questionnaire was sent to the respondents in advance so they could prepare in detail. The questionnaire was also designed to be generic in approach so that no one particular transaction dominated the conversation.
- Social desirability bias may occur if respondents attempt to gain prestige from the interview. To reduce this all interviews were conducted on a one-to-one basis. There were no group dynamics to be navigated and all interviews were conducted on the premises of the respondent to make the environment as comfortable as possible.
- Literacy – not in terms of general literacy, but in terms of jargon used in both the marketing and corporate finance fields. For example corporate finance specialists do not necessarily understand marketing terms in the same context. To reduce this error the purpose of the research and some of the terms were briefly explained prior to the interview.



4.12.2 ADMINISTRATIVE ERRORS

- Interviewer bias may occur in personality reactions to questions based on demographic characteristics such as age and gender differences of interviewer and responder (Zikmund, 2003). To reduce this error all interviews were recorded to demonstrate transparency and confirm the need for an academic record of the transaction. Analysis of the interview has occurred in terms of the written transcript and the auditory recording to attempt to reduce personality reactions.
- One of the limitations of the personal interview is that the interviewing parties come together face-to-face. As much as this technique has significant benefits, a potential disadvantage is in differential interviewer techniques (Zikmund, 2003) which may be a source of bias when questions are rephrased, the interviewers tone varies and judgement occurs due to physical appearance.



4.13 LIMITATIONS

Table 9 confirms that 1,627 transactions (72%) of the 2,265 transactions noted in the E&Y database for 2005 and 2006 reflect that no corporate advisors were involved in the transaction. These transactions account for R113, 508 Million (21%) of the total value which suggests that corporate advisors are principally involved in the larger value transactions.

There may be informal advisors involved in these transactions but no reference of their activity is publicly recorded and therefore these could not be described or included.

In terms of M&A value of transactions the respondents interviewed were certainly involved in the majority of transactions. Alternative approaches could have focussed more broadly in interviewing more practitioners, or more deeply in probing many practitioners in one corporate advisory group.

There is an element of duplication in terms of the corporate advisors interviewed as well as the attorneys involved in M&A activity where more than one of the respondents has been involved in the same transaction. Typically this occurs where the corporate advisor requires specialist knowledge such as legal services or where different elements of the transaction are delegated to other advisors to improve disclosure levels; diligence through cross-auditing and to improve governance through transparency between advisors in the transaction. Total transaction values reported above are not affected by this, but any individual split to apportion deal value is not possible.



Some of the brand concepts are foreign to corporate finance players and therefore there may be some misunderstanding in answering the questions based on the respondent's framework of unfamiliar concepts and definitions.

It is not within the scope of this research to determine the changing financial values of brand equity following a merger although such a study would prove insightful for future researches as it so very closely linked to competitive advantage shown above.

Personal interviews were conducted to gain explorative insight in the M&A process but due to the nature of these face-to-face interviews there is "no anonymity" and individuals may be reluctant to provide information regarding specific transactions of a confidential nature (Zikmund, 2003, p. 203).



Chapter 5. RESULTS.

5.1 DATABASE OF M&A TRANSACTIONS

A database of all M&A transactions occurring in South Africa during 2005 and 2006 was obtained from Ernst and Young, with permission of Mr Dave Thayser who is a partner in the firm and the head of the Corporate Finance division in South Africa. The purpose of gathering and analysing this data was to investigate the level of involvement of the corporate advisors interviewed; and to place M&A activity in the South African context into perspective.

5.1.1 M&A ACTIVITY

The value of M&A transactions in South Africa increased by 5% from R269,5 Billion in 2005 to R283,6 Billion in 2006 while the number of transactions actually decreased by 18% from 1243 in 2005 to 1022 in 2006 as shown in Table 10.

Table 10 – Total Value and Count of M&A Transactions for 2005 and 2006.

This table was created by the author from data supplied by E&Y.

Month	2005		2006		Total Value (R – Million)	Total Count
	Value (R – Million)	Count	Value (R – Million)	Count		
Grand Total	269,543	1243	283,603	1022	553,146	2265

The average value of a transaction increased from R216, 8 Million in 2005 to R277, 5 Million in 2006. The top 10 largest value transactions collectively amounting to R179 Billion worth of transactions for 2005 and 2006 are recorded in Appendix I.



5.1.2 M&A MOTIVATION

The E&Y database lists 44 features or motivations for the M&A activity recorded through 2005 and 2006 in Appendix J. The top 10 Features by total value account for 84% of all value of the M&A transactions as follows:

Table 11 – Top 10 motivations for M&A

Analysed and created by the author from E&Y data of M&A transactions for 2005 and 2006 and sorted by total value of transactions

Feature	2005		2006		Total Value (R Mio)	Total Count	%age change in value	%age change in transactions
	Value (R Mio)	Count	Value (R Mio)	Count				
Acquisition of Related Business	92,520	439	36,740	325	129,260	764	-60%	-26%
Outward Investment		3	61,598	65	61,598	68		2067%
Black Economic Empowerment	8,352	153	45,715	215	54,067	368	447%	41%
Merger of Related Businesses	46,177	39	1,094	27	47,271	66	-98%	-31%
Conditional Offer	44,089	131			44,089	131	-100%	-100%
Disinvest by Foreign Company	4,058	9	26,065	12	30,124	21	542%	33%
Section 311 Scheme	8,045	14	20,799	8	28,844	22	159%	-43%
Share buy-back	5,836	38	21,398	32	27,233	70	267%	-16%
Other	11,722	138	10,338	93	22,060	231	-12%	-33%
Investment in RSA by Foreign Company	8,126	17	10,461	40	18,587	57	29%	135%



The majority of transactions are acquisitions and mergers of **related business** operations which account for R129, 260 million and R47, 271 million respectively, as highlighted above. Where business operations are related it is likely that similar clients and similar products are in consideration, and that vertical or horizontal integration strategies are at stake. For this reason the due diligence activities could have a significant brand orientation by verifying and identifying the common customers and markets that these related businesses previously competed in and therefore the impact that such integration would have on the future cash-flows of the merged businesses.

The alignment of corporate brand offerings of previously competing brands, similar customer profiles and related product offerings should feature in the pre-deal due diligence process.

Table 12 – Related business M&A detail for 2005 and 2006

Analysed and created by the author from data supplied by E&Y regarding M&A activity in South Africa

Feature	Count of transactions		Value (R-Million)		Total Count	Total Value (R-Million)
	2005	2006	2005	2006		
Acquisition of Related Business	439	325	92,520	36,740	764	129,260
Merger of Related Businesses	39	27	46,177	1,094	66	47,271
Grand Total	478	352	138,697	37,834	830	176,531

As evidence that brand issues should be included in the due diligence process with regard to related business M&A, the following comments and explanations are given for some of the transactions recorded on the E&Y data:

- Acquisition of 49% of Halsted Investments (Pty) Ltd manufacturer and distributor of **branded** tools under the Lasher **trademark**.



- Pioneers Foods acquires Marmite, Bovril and Maizena **brands** from Unilever
- Boschendal wineries acquisition of wine business, including the wine **brand**, winery, cellars and production facility from DGB (Pty) Ltd.
- Acquisition of restaurant **brands** from Top Restaurants Ltd by Cyberhost Limited from an undisclosed seller.
- Tiger Brand Ltd acquires rights to Vita Thion a leading **brand** in the energy tonic market from an undisclosed seller.
- Acquisition of the assets, including designs, **brands, trade marks, drawings** and manufacturing equipment of Hukla Möbelwerke GmbH.
- Acquisition of the business of MotoQuip Group including the Moto Quip, Leisure Quip and Travel Quip **brands** by Brandcorp Holdings Ltd
- Brimstone subsidiaries House of Monatic and Fifth Element Marketing acquire sportswear **brand** Canterbury SA
- KVV acquired a controlling share in NMK Premium Global **Brands**

5.1.3 CORPORATE ADVISORS

The top 20 corporate advisors in terms of number of transactions is listed in table 11 and sorted from highest number of transactions to lowest. There were no corporate advisors recorded to be involved in 1,627 (72%) of the 2,265 transactions occurring in 2005 and 2006.

Table 9 confirms that 2,265 transactions were concluded for the 2005 and 2006 period and that the value of these transactions was R553, 146 Million. Yet the count of the transactions as well as the sum of financial value of the top 20 advisors listed in table 11 significantly exceeds this figure.



The reason for this inconsistency is that there is often more than one advisor involved in the same transaction and therefore the full value of the transaction is counted towards and accredited to each advisor as it is not possible to pro-rate the value of each transaction to the individual level of involvement of the advisor. The same methodology is followed by Thayser *et al.* (2005).



Table 13 – Top 20 corporate advisors in M&A for 2005 and 2006.

The information was created by the author from data supplied by E&Y and is sorted by the count of transactions for the period.

Corporate Advisors		Count (Transactions)	Value (R – Million)
1	No corporate advisor recorded	1,627	113,508
2	Java Capital	81	11,397
3	Nedbank Capital	60	38,829
4	Sasfin Corporate Finance	57	4,530
*5	Investec Bank	51	32,989
*6	Bowman Gilfillan Attorneys	47	77,938
*7	PriceWaterhouseCoopers	45	53,158
8	Deutsche Securities	45	178,176
*9	KPMG	37	37,605
*10	Ernst & Young	37	21,966
11	Standard Bank	36	37,369
*12	Deloitte	31	10,347
13	Rand Merchant Bank	29	51,850
14	PSG Capital	28	3,634
15	JP Morgan	25	83,997
16	Moore Rowland	22	1,917
17	Bridge Capital	22	3,627
18	ABSA Corporate & Merchant	19	17,699
19	icapital advisers	16	1,148
20	Citigroup	14	45,517
	TOTAL	2,329	R 827,201

*All the M&A corporate M&A advisors that were interviewed are within the Top 20 and highlighted in the table above.



5.2 RESPONDENTS FOR EXPERT INTERVIEWS

Expert interviews were conducted with management in corporate finance, brand consulting, tax and business valuation of the following corporate advisors:

Table 14 – Corporate advisors interviewed

Corporate advisors	Party interviewed
Bowman Gilfillan Attorneys	Dr Wim Alberts - Trade Mark Consultant
Brand Metrics	Prof. Roger Sinclair – Managing Director
Burlington Corporate Strategy Advisors	Mr Alistair Brockwell – Consultant and strategy advisor.
Deloitte & Touche Corporate Finance	Helgo Rapsch - Group Tax director
Ernst & Young Corporate Finance	Mr Dave Thayser – Partner and Head of Corporate Finance division. Mr Sean McPhee – Director, Transaction Advisory Services.
Investec Bank	Mr Kevin Kerr – Head of Corporate Finance division
KPMG	Mr Mickey Bove – Partner and Head of Corporate Finance division
McKinsey Consulting *(interview done telephonically)	Dr Tjark Freund – Worldwide brand specialist. Marketing and sales practice head, Hamburg Germany. Recipient of The Federation of German Market and Social Researchers (BVM) 2006 Fellow Market Researcher Award.
Pricewaterhouse Coopers	Mr Peter McCrystal – Director Transaction Services
The Disruption Consultancy – member of TBWA	Mr Jason Levin - Brand specialist and strategy consultant.

*Having begun discussions with McKinsey’s Consulting in South Africa I was unable to get the depth needed in response to the research questions. I was therefore referred to Dr Tjark Freundt in Hamburg, Germany to explore the research telephonically.



5.3 THEMES OF DISCUSSION

In line with the research questions described above, information was obtained regarding the three key issues being explored as follows:

- The brand concept in M&A due diligence.
- Roles of corporate advisors in M&A.
- IFRS 3 legislation and impact on M&A.

Through exploration of these research questions the surveys generated six consistent themes of discussion which will be explained in detail below, as follows:

- Brand is generally an afterthought
- You're not registered for popcorn
- Due diligence is actually about
- Sometimes there is a conflict of interest
- IFRS 3 is a balancing act

5.3.1 "BRAND IS GENERALLY AN AFTERTHOUGHT."

Brand is not highly regarded in its own right in M&A activity. Respondent 3 stated that "from a due diligence point of view, we don't necessarily go and look at those things." Respondent 8 makes it clear that "you've got the brand agencies and you've got the financial people and there is no connection between the two" and that "brand is being totally ignored by current practitioners."



Respondent 3 stated “I can tell you from our experience, brand generally is an afterthought.” As the “value is all around the cash flows that it (*brand*) generates,” while respondent 1 confirmed “our job is very technical, there’s nothing soft. We don’t go into the brand image or the PR side of it”. Respondent 2 confirmed: “I think the tax division is very often the engine-room of any transaction. We basically say well does it work from a tax perspective” before looking at the transaction. Respondent 4 agrees, saying: “I’m not worried about how you carve out little bits because it’s all in the overall value of the business. I don’t care how you allocate the little parts – the accounting profession’s got very tied up in doing that in the last few years, I don’t think it matters;” “the only time it would matter was if the brands weren’t getting sold in which case you would need to value them or if you were only buying the brands – and not the rest of the business.”

Respondent 6 agrees that activities are “focussed predominantly on financial and tax” issues where their role is “to try and give credibility or provide some robustness to underlying assumptions in the valuation model going forward.”

Respondent 7 stated “there is not brand due diligence as such that we do,” as there is “no specific work stream which is connected to the brand or branding in any way.”

Respondent 5 agrees, confirming “we’ve never been asked to look at a brand in particular” and that “a person buys a business based on its future prospects”.



Even the sellers do not regard the brand in the transaction as respondent 5 states: “brand to him (the seller) is not an issue because he’s selling his share of the business. Respondent 4 stated in “some businesses brand matters, it’s the most important thing you’ve got, in some businesses it doesn’t matter, depends on what you’re actually buying and why”. Internationally the same trend seems prevalent as respondent 10 stated “quite honestly, speaking for Europe it (brand) was not on the top management’s agenda.”

Respondent 8 states that “M&A experts view intangibles as yet another asset they do not understand that they come about because of marketing activities.” These activities drive the cash-flows that they are actually after in terms of their analysis. In general terms the “focus is on cash flows.” The corporate advisors want to understand and report on the cash-flows and they do not generally attribute the cash flows to brand or to customer activity.

Respondent 8 was very clear on the issue that “the only way, any asset, particularly an intangible asset, has a value is if it has customers and those customers buy regularly and the customers come about because of marketing activities. So its marketing activities that build the customer base and marketing activities that keep the customers loyal to the brand and the income flow which creates the asset comes through to the customer.”

Respondent 3 summarised it well by saying “a deal doesn’t happen unless there is perceived value. Perceived value might be in a management team, it might be brand but the ultimate outcome of all of these elements is value being tangible or intangible, is the cash flows that they generate.”



Respondent 8 was concerned that “there is an ignorance out there and this could be ascribed to the fact that they are not taking into account the marketing activities of building and keeping customers.”

Equally, respondent 7 confirms “the value of the brand is implicit in the value of the future cash flows because when we value a firm we don’t look at the assets as much you actually look at the value of the future discounted cash flows, so I guess the assumption is that the value of the brand is one of the drivers of sales which is in turn one of the main drivers of future cash flows. So the point is really that’s it implicit.”

5.3.2 “YOU’RE NOT REGISTERED FOR POPCORN.”

According to the respondents, branding and marketing does count when it’s relevant. Identifying relevance from the respondent’s perspectives is a challenging issue as it is very subjectively interpreted.

Respondent 1 stated “you get a product life cycle, then you must tell the client you’re not registered for popcorn. His response is, we don’t care anymore.” In this example product life-cycles were evaluated by legal advisors with the purpose of registering trade marks or patents for the “popcorn” products. The product brand names that still have a reasonable life cycle remaining are appraised for registration. Product life cycles are certainly marketing issues, related to the brand longevity however the focus from the corporate advisor was only about the practical elements of legal registration. The brand connection was essentially ignored.



There are many instances when brand is deeply considered, but the corporate advisors just don't think in terms of marketing or brand terminology. Respondent 8 explained why this is so, saying "IFRS3 is the focal point of what you're talking about and it is being interpreted by financial people and not marketing people, financial people are looking at it purely from the way they have always done things. They don't even contemplate marketing."

The link is tenuous as respondent 3 confirms the "brands are intangibles - plus the assets are needed to create those cash flows and that's generally what the buyer is interested in." whereas respondent 5 confirms it is generally the buyers responsibility to understand the brand values. He confirms that "most of the time the trade buyer would do their own work on brand, because they understand the industry better than anyone else."

By default then, brands do play a role in M&A activity and some of the evidence presented by the advisors includes:

- Respondent 2 stated "I've never thought about marketing or brand DDR but I certainly see that there could be scope for it."
- Respondent 1 confirms "we get information from them in terms of their major products, annual reports; information from the marketing sections etc. to make sure that the main products, the main money spinners are protected and no-one can come and steal the IP (patents, copyrights) once you've taken over the company" and that "we would always check to make sure the important types of logos and designs that the copyright is in fact lie with the target company."



- Respondent 2 incorporates “the logo aspects” and analysis of “ the customer base” as well as “the established product names” to ultimately state “I’ve never thought about marketing or brand DDR but I certainly see that there could be scope for it.”
- Respondent 3 states “I agree with you 100% and what we’re seeing is the guys make the investment in the cash flows that that brand generates.” “The bricks and mortar that you can sell today. Everything else is customer relationship, loyalty, brands, products.”
- Respondent 4 suggested “you need to assess and be very sure if you want to retain the name why you retaining it, what benefit you receive from it, so those debates do happen.”
- Respondent 5 stated “the true merger I see as two companies coming together and creating one company. That’s where I think brand is very key, because you have two different companies potentially in the same market space and brand becomes essential.”
- Respondent 6 stated that although no marketing due diligence is done that external advisors are often employed to focus on brand and “you find the private equity guys will typically employ a market consultant, a guy who looks at the commercial aspects of the transaction” and “the strength of the brands, their positioning, who the competitors are, what the competitors are doing, what the company’s doing, growth of market share as well as “their customer base or who their suppliers are” if “you want to re-position yourself or you want to re-brand.”



- Respondent 7 agrees “If the brand was destroyed, how would you get it back?” and that “we need to value the brand inasmuch as how much does the brand strength impact the sales.’ He also suggested that “I think it’s documented that many of the deals that are done fail not because of problems on the financial side, that’s all sound, but it’s all the fluffy stuff in-between that is a basis for failure.”
- Respondent 8 confirms “your due diligence really ought to include an investigation of the customer base, how stable it is and what is being done to protect it.”
- Respondent 10 confirms “there are two trends that we are observing, first of all the brand as such is gaining momentum and is being recognised as being one of the most important intangible assets the company may have. He also verified “that on average, something between say 60% to 70% of the total price being paid for companies, if it’s an acquisition, is actually attributed to the brand.”

5.3.3 “DUE DILIGENCE IS NOT ABOUT INTANGIBLES.”

Even though there is legal and compliance pressure in terms of IFRS 3 there is a weak relationship between due diligence to verify intangible assets.

“On the due diligence side we don’t report on what the intangibles are and put a value on that, generally that gets done post transaction when we differentiate in terms of the statements” says respondent 3. Respondent 6 agrees, stating “due diligence doesn’t that often go to identifying intangibles. We try more to understanding the underlying business as opposed to being technical in terms of IFRS.



Evidence of this fact is that a DD checklist provided by this corporate advisor is attached as Appendix C1. An exploration of the checklist confirms that only 9 of the 89 intangible assets determined by IFRS as shown in Appendix D are included in the DD checklist. This is probably why the respondent confirms “we don’t really work on checklists.”

There is no single outline or structure in the due diligence (DD) process as respondent 3 confirms “I don’t think its as black and white as that and certainly in terms of the brand, it mainly goes around market differentiation”.

The DD process is dynamic as “it’s really agreed with the client what is of interest to them” It is formal and structured as “we have a global methodology – whether we do a due diligence here or overseas, we do follow that methodology.”

It is important that the advisors identify with the M&A motivation to extract the best value and therefore respondent 6 confirms “we try to be upfront and try to understand why they’re doing the due diligence, we almost challenge the strategic rationale for doing the transaction upfront.”

Due to perceived risk respondent 4 states “we don’t do any third party due diligences we let the auditors do that” as “you can get sued for a lot of money if you mess it up.”



There are many kinds of due diligence, each with their own focus and outcome. Respondent 7 confirms the variety and states “we offer specific products to private equity houses and the whole due diligence world is multi-faceted. It involves many different types of due diligences. The ones we deal with are primarily the commercial, we also touch sometimes on management due diligences, that would be looking at the management team itself and understanding whether or not they are well positioned to extract the full value of the potential opportunities that business has.”

Respondent 3 states “I think the most important thing is the scoping up front with the client, what the client wants to understand about that business.” The areas of focus are quite different between” different buyers.

Respondent 3 says “I think what’s very important is that you realise, and that’s our philosophy, that due diligence is not a structured process like an audit.”

Therefore the motivations for due diligence differ dependant on the client approach and scope of the transaction but in general, are required to verify the proposition or to discover unknown information.

From a legal perspective respondent 1 confirms that”trademarks, copyright and patents are the main issues but then the know-how can also be massive – there you would have to have very tight employment contracts”. He also mentions “designer rights.



The designer rights would be for example the shape of things. I would say it depends on the nature of your business, e.g. Jenna Clifford, it would be critical.”

“The whole thing is (about) shapes” where design ownership of the iconography must be established. Respondent 2 confirms “you are definitely going to look at your customers and your suppliers from a legal perspective” and respondent 5 agrees that legal issues are important as he states “in terms of scoping a due diligence sometimes there is the question, potentially from a legal perspective to try and identify what IP a company has.”

Respondent 3 states they “will confirm a lot of those assumptions based on historic performance” in terms of the valuation model.

Respondent 3 confirms “the most important thing for the acquirer is to understand exactly (what) they’re buying (in) this business, how are they going to integrate it.”

Respondent 2 states that “Private equity firms don’t normally want to run the business so, they look at management” in terms of DD. He also advises that “culture is most probably a hugely under rated aspect of a transaction” and respondent 4 agrees “they’ll be assessing culture fit right through the business,”

Respondent 5 says “If you’re talking culture it’s sometimes in the pay charge due diligence you would uncover that but its very limited its more from a legal perspective so they’d look at legal issues rather than culture.”

According to Respondent 6: “In some transactions due diligence is provided purely, not to support the valuation, (but to determine if there) are there any deal breakers; yes or no, it’s a kind of a black holes due diligence.”



All the respondents confirmed that DD is charged out to the client on a contract rate according to the time it might take to complete the assessment.

In broad terms DD is very tailored and flexible. It is customer driven in terms of the scope the corporate advisors receive. It focuses on output; mainly the cash-flows that are generated from the valuation model and are in place to defend, support and justify the value and validity of the transaction. In terms of overarching responsibility respondent 5 confirmed that “the buyer of the company ultimately has to account for that company in its own books” and that the DD is driven to support the transaction.

Respondent 8 suggested that in terms of cash-flows “that it is all linked to customers” and that “you do not have any value unless you have customers” and therefore it is remarkable that a DD is credibly compiled without significant scrutiny of the brand or intangible assets which drives the customer behaviour.

5.3.4 “IT’S A HUGE CONFLICT OF INTEREST.”

Respondent 2 suggests that the full values reported by the various M&A databases are not reflective of all the activity as “merger and acquisition doesn’t give you the full description because it also includes disposals of non-core assets.”

Conflicts may exist where there is a perceived conflict of independence and where there is a conflict in pricing and regulatory controls. The following possible conflict examples have been confirmed by the respondents:



▪ **Independence conflict**

Respondents 2 and 3 confirm “we’re not prohibited from doing a due diligence for a channel one client, being an audit client.” Respondent 5 confirms “independence is always an issue so we need to weigh it up.”

Respondent 2 states “In the ideal world we would like to do all the M&A advice on all our clients – there are always the questions of independence because at the end of the day the auditors are signing off on basically (what) their colleagues have advised on.”

Conflict may also become evident in management as respondent 2 confirms “the two competing CEO’s both think they should be the CEO’s and its falling apart. Who do you make Chairman, MD or CEO, who is the FD going to be and I don’t think, generally speaking that the personalities involved allow external parties to say lets look at what is available and lets assess the qualities of the people because they may not be there anymore. It’s a huge conflict of interest.”

There may be a conflict between the different divisions with the corporate advisory operations. For example between audit and transactional services. To avoid the potential risk respondent 6 confirms “We have very strict internal policies in terms of managing conflicts that can arise. We may form a view on something that is in conflict with what the audit division, or may pick up an issue that wasn’t picked up during the audit, but we have very strict Chinese walls in place that if I’m doing a due diligence on an audit client that audit partner may not talk to me and I may not talk to him unless we follow the exact same procedure.”



Respondent 10 says “I think it's fair to say that a lot of M&A companies are too transactional.”

▪ Pricing conflict

Respondent 2 questions some of the brand valuation methodologies as does respondent 8 asking “How do you choose a royalty rate, you can't benchmark it?” The brand valuation methodology “is a completely discredited methodology that they all use” and is subject to the following criticism from respondent 8:

- “brands last an awful long time - now accountants aren't used to that – they are used to the idea that assets depreciate – they have no conception about brands”
- “So they base it on turnover. Whereas any sensible business person wants to see what the margins are – are we making a profit?”
- “the entire thing is based on a lack of understanding of what intangibles are, particularly brands”

▪ Fee conflict

Fees are strictly controlled to avoid any conflicts and are normally time based. Respondent 3 confirms that all pricing in terms of service is done on a time based cost and states: “To expand on that a bit the reason it is time based is we can't take the success based fee in terms of conflict and independence, if you say pay me 20% upside if you do the deal the perceived concept is we'll only tell you good things.” Respondent 5 agrees” if you're getting paid 120% if the deal's successful or 80% if the deal fails, you're urged to make the deal succeed.”



▪ **Regulatory conflict (IFRS)**

Respondent 5 confirms “people want to attribute as little as possible to goodwill” as it affects the income statement negatively. Respondent 6 agrees that “as a consequence, people try and leave things in goodwill now to draw down the value of the intangibles because it hits your income statement. So, you’ve got this inconsistent treatment that in my view needs to be addressed by IFRS.”

Respondent 10 confirms the accounting treatment of goodwill is not relevant to the life of a brand as “they would write it off as an exercise for saving tax.”

▪ **Responsibility or performance conflict**

Some of the integration issues are so sensitive particularly when addressing culture that respondent 4 confirms “you can’t outsource that to consultants or third parties. It’s right at the heart and soul of that business. I think the key individuals in the organisation need to be involved in that process.”

Respondent 5 confirms that “when you come to smaller companies the books aren’t that great because they’re not reported to anyone.”

Respondent 5 confirms that sale values are potentially over-rated as “trade market buyers are often losing out to the private equity players so there are fewer assets and the guys are paying more – so they’re prepared to pay more of the synergies away.”



Respondent 5 looks at management and confirms some risk might exist
“where you’ve said to the target or buyer this management is great, imagine if it
turns out to be bad they’ll say but you guys were there.”

Like any specialisation, respondent 10 confirms in terms of service performance
that “knowing something about marketing is not enough you have to know the
detailed trends.”

Respondent 10 confirms that after the merge it is often extremely difficult to
integrate brands based on their former, possibly conflicting messages and that
“it was quite a challenge to bring these two businesses systems together which
has obviously affected not only sales and marketing but all of the underlying
processes with regard to contract management.”

5.3.5 “IFRS 3 IS A BALANCING ACT.”

According to respondent 8 “IFRS 3 specifically states that goodwill must be
broken down so in a merger and acquisition, if there’s goodwill over net asset
value it has to be broken down to explain what it comprises and the standards
say brand will, not might be, will be one, so there is no doubt, it is specified in
the guide to the standard, so there is no question. Goodwill must be reduced as
goodwill can no longer be treated as an asset.”



In practice however goodwill is not managed as judiciously:

- Respondent 2 says: “You would value the business as a whole first of all – is it a profitable business, does it generate the cash flows, will it be able to pay off the purchase price then I think its only a secondary question as to where it (intangibles) fits in.” “You’ve always got to be mindful of what the accountants think or the F.D. because you want to report headline earnings. From a tax perspective, yes if you’ve got plant and you sell it as a business as a going concern you don’t have corporate relief provisions, very often you’ve got massive recoupments that means tax at 29%. If you can contribute it to say goodwill, goodwill doesn’t have any costs of a capital nature so you just need to look at the base.”
- Therefore “It (goodwill) is of a capital nature and that would attract capital gains tax at 14½%, so looking purely at the tax arbitrage I would try to attribute as little as possible to plant and more to goodwill. That’s assuming you bought it and contributed an awful lot of value to the plant, guess what your headline earnings show – depreciation. If I’ve got goodwill I only impair it if there is a reason to impair. So my headline earnings look an awful lot better if I attribute the purchase price to goodwill than to plant.”
- Respondent 2 confirms “In the perfect world there is no goodwill, it’s all attributable to contracts, copyrights patents etc.”



- Respondent 6 says “goodwill is the (balancing) number that falls out, but it is a balancing exercise.” “On occasion you end up with negative goodwill – I’ve seen a number of transactions like this - so what they’re saying is your tangible assets plus intangible assets are greater than what you’re selling the business for. IFRS says when you end up with that answer go back and re-check your calculations because you’ve probably (made a mistake). So you go back and re-check and say I’m happy with what I’ve got – so you’re buying / selling at a discount.”
- Respondent 8 confirms “there is another standard which is being worked on but it will be quite a number of years it’s called IAS38. IAS38 deals with intangible assets and is a companion to IFRS3.”
- Respondent 10 confirms the accounting treatment of goodwill is not relevant to the life of a brand as “they would write it off as an exercise for saving tax.”
- Respondent 5 confirms “people want to attribute as little as possible to goodwill” as it affects the income statement negatively. Respondent 6 agrees that “as a consequence, people try and leave things in goodwill now to draw down the value of the intangibles because it hits your income statement. So, you’ve got this inconsistent treatment that in my view needs to be addressed by IFRS.”



5.4 SERVICES

The kinds of services that are broadly on offer from the respondents vary in slight detail but are mostly quite generic in terms of the industry. For example, the corporate advisors mostly offer M&A transactional services. In fact, in 3 of the consulting firms interviewed the business unit is actually called “transactional services” which unlike the longevity of its corporate brand conjures up the image of a commodity type offering and almost a single-function business.

In reality it is not like this, as the majority of corporate advisors are also accounting and auditing firms and therefore have a longer term relationship with their clients. It was interesting to note that many of the auditing firms who offer M&A advisory work refer to a tier one client as the auditing client and the tier two as the transactional / tax or some other service that is not auditing.

In other words the auditing function seems to capture the number one position in terms of ranking, which may or may not be deliberate as the preferred approach to the client.

The M&A Advisory services discussed in detail according to the responses gained generally comprise:

- Valuations
- Transaction support
- Due diligence
- Tax support
- Business modelling



5.4.1 VALUATIONS

The valuation service could include business valuations, intangible asset valuations such as patents, trademarks and copyrights and options valuations.

The term valuation was used about 43 times in conversation and here follows some selected responses in the applicable context:

- “In terms of valuation the client generally would come up with their investment case, how they valued it, the due diligence will confirm a lot of those assumptions based on historic performance”
- Confirmed by respondents 2 and 3 respectively that “If we are the auditors, we can get involved in the M&A activity but with certain limitations e.g. we can never do the legal work, we can never do anything which involves valuations, we can never take decisions – we can advise but we cannot take the decisions” and “if we were the auditors to the company, we cannot do the price allocation so you’d find one of the other big four would do it. They would value the business that’s being acquired by the buyer and they would look at how they would attribute that value.”
- “We don’t do the valuation but we try covering things that may impact the valuation.”
- “We’d typically get access to that valuation model and we’d try and give credibility or provide some robustness to underlying assumptions in that model going forward, be that to see if your historical trend is on track or to challenge the assumptions in the thing going forward.”



5.4.2 TRANSACTION SUPPORT

Transaction support could include, drafting of legal documentation, commercial analysis, post deal solutions and working-capital management.

In some instances the suite of service is detailed and may even include advisory consulting, negotiation of terms, project finance, facilitation, capital raising, sourcing private equity investments, transaction structuring, formation and structuring of joint venture agreements, BEE advisory, consultative services to either buyer or seller and post acquisition integration and change management.

5.4.3 DUE DILIGENCE

There are varying types of due diligence, dependant on the specialisation required which include financial due diligence, acquisition due diligence advice, commercial due diligence, management due diligence, vendor due diligence, legal due diligence and tax due diligence. The term “due diligence” was used in conversation approximately 274 times and discussed in detail above.

5.4.4 TAX ADVISORY

Tax support could include tax structuring advice for the transaction and post M&A tax efficiencies. One respondent stated “the tax division is very often the engine-room of any transaction, so much so that if the deal is inefficient from a tax perspective it doesn’t go through”



Some specific comments regarding tax included:

- “Certainly we’re seeing the legal firms competing very strongly on the tax area, and tax structuring”.
- “Often the team that does the financial will do tax as well”.
- “I’m on the due diligence side and its predominantly tax and finance that we would get involved in”.
- “I was once privy to one similar to that in terms of a VAT issue – the company saved something like R300million after the deal just in VAT, just by them putting together structures.”
- “Our approach is more driven by eliminating tax leakage “.

5.4.5 POST M&A SUPPORT

Post M&A support could include business modelling, business model building, reviewing, training and business plans and integration consulting as follows:

- Respondent 2 confirms “we do sometimes do sensitivity studies – we do a lot of simulation based work and that sometimes fits into what the clients are doing.”
- Respondent 3 states: “Generally the private equity guys don’t know the market landscape, the competitive behaviour of the business. So if we’re doing something for a private equity player that comes from a position of less knowledge, we would maybe do a fuller scope due diligence as opposed to a trade buyer who would be focused on certain specific elements.”



- Respondent 3 says “the first 100 days is the most crucial period, where you need to integrate. If you don’t get the first 100 days right, the chances are that that merger or acquisition is not going to be successful. So we do offer some services that look at that 100 day plan and a lot of it is driven off the findings of the due diligence.” Respondent 6 agrees and discusses the first three months in terms of integration while respondent 10 looks at “the transformation element” after the transaction is concluded.
- Respondent 4 says “we’d work out what skills the client has and what we need to add into it to get the transaction to a conclusion. So we’d advise a client on how to position himself tactically in negotiations, in structuring the deal from his perspective whether is debt or equity and if he does, then we help him raise that debt or equity.”
- Respondent 5 confirms the post deal trend and states “post deal is something we haven’t ventured into yet. We’ve started to look at that. In the UK they have been very successful.”
- Respondents 5 and 6 offer Human resource solutions to deal with culture conflicts.
- Confirmed by respondent 9 and respondent 10 who discusses the theme that, “for most clients its actually very important to not only have a one time (brand) valuation but a long term tracking tool and to have a continued long term tool to actually manage and track the brand value.”



Chapter 6. DISCUSSION OF THE RESULTS.

The research questions developed above form the basis of discussing the results and presenting the implications of the exploratory findings. The research questions were developed to discover three issues, namely to:

- Investigate and explore to what extent the concept of brand is considered in M&A due diligence in the South African context.
- Evaluate and explain the differing roles that the selected corporate advisors put forward in the M&A market regarding brand in South Africa.
- Interrogate how M&A practitioners are operating in terms of IFRS 3 legislation.

6.1 THE EXTENT TO WHICH BRAND IS CONSIDERED IN M&A DUE DILIGENCE?

The extent to which BRAND is considered is a very specific enquiry.

Why brand? Why not the extent to which landing rights or training manuals are considered in M&A due diligence? These too are intangible assets. Why not any one of the 89 other intangibles that are listed in Appendix D?

The answer lies in the literature review in terms of what brand is. Aaker (1991) confirms a brand is unique and timeless and defines brand equity as a set of brand assets and liabilities linked to a brand.



Keller and Lehmann (2004) confirm companies are recognising that their financial wellbeing is based on the value of their customers and that improvements in brand equity are directly and positively related to share price. “Firms who experienced the largest gains in brand equity saw their stock return average 30%; conversely, those firms with the largest losses in brand equity saw stock return average a negative 10%.” (Keller and Lehman, 2004, p. 18)

Therefore the brand assets and liabilities of brand such as brand loyalty, name awareness, perceived quality, brand association and other proprietary brand assets, as per figure 3, make up the components of brand equity (Aaker, 1991).

Adapted from Aaker (1991), table 3 confirms that brand equity provides value to the customer, which enhances value to the firm, ultimately creating competitive advantage. For the purposes of this research, brand is considered as the corporate brand which is not restricted to the organisation as it has “value and durability”. (Balmer and Gray, 2003, p. 985). The importance of staff and corporate culture begin to filter into the role of a corporate brand. The corporate characteristics described in Table 1 confirm that the corporate brand is not just about the company name or iconography. It has depth and consequence in creating competitive advantage (Aaker, 1991; Keller, 1993).

Brand is the therefore the link to customers. It is a source of competitive advantage in distinguishing the firm from its competitors and substitutes; and therefore it should feature predominantly in any M&A transaction. When brand marketing does feature in M&A customer retention, service quality and improved customer perceptions occur. (Homburg and Bucerius, 2005).



A motivation for M&A is to acquire well known and proven brands at once, to hedge against the high costs and the risks of product development (Mahajan, Vithala and Rajendra, 1994; Swystum, 2001; Thayser, 2005). M&A provides firms with the ability to gain access to new markets, amass economies of production and to strengthen the existing market positions (Mahajan, 1994; Preston, 2005; Hogan, Glynn and Bell, 2003)

Without effective synergy of brand in M&A the likelihood of failure increases according to Perry and Herd (2004). Ettenson and Knowles (2007) confirm that marketing and brand should be incorporated in the pre-deal phase to sell the brand and communicate the future of the merger; to find key relational assets that drive cash-flow and to look beyond deal breakers with more of a positive orientation to find factors that would enhance success.

Therefore brand is being explored, and not the remaining intangible assets, as it seems to make a difference. It appears from the literature review that a strong focus on improving corporate brand equity might improve competitive advantage of the firms post merger. Heberden and Haigh (2006) suggest though that brand is neglected in M&A planning.

Respondent 8 confirms “that up until 2005 with the introduction of IFRS 3 that brands did not feature on the balance sheet.” He also states that M&A experts view intangibles as yet another asset and they do not understand that these intangibles come about because of marketing activities.



“So its marketing activities that build the customer base and marketing activities that keep the customers brand loyal and the income flow, which creates the asset, comes through from the customer.”

Smith (2002) determines that intangible assets like brands account for the bulk of corporate value. Respondent 10 agrees and confirms that brand as such is gaining momentum and is recognised as being one of the most important intangible assets a company may have.

However, from the survey interviews, the corporate finance advisors involved in the due diligence processes do not seem to appreciate the value of brand to such a significant degree. Their focus is rather on the output of brand. Their focus is generally on the cash-flows that it generates through customer sales transactions and so their role in M&A activity is to test and verify the assumptions that generate these cash-flows. Brand is generally an afterthought in its own right, as a pure marketing concept.

This does not mean to imply that brand has no value, or that it is not important. It simply means that the corporate finance practitioners prefer to interact with the financial proxy for brand in terms of its actual deliverables; in terms of the brand valuation and in terms of the calculated cash-flows it might produce in the future. By default brand is part of the consideration in terms of its output.

Brand is therefore considered only in terms of the cash flows it generates. Considering this is the purpose of brand creation the approach is not entirely unsound.



In some instances the new entity is considered with regard to any new brand that might be developed after the merger (Respondent 4 and 8).

In some cases the culture fit and human resources of the merging entities are considered (Respondent 2, 3, 5 and 6).

In terms of the components of brand equity (provided in Appendix A, adapted from Aaker, 1991) there is very little evidence from the expert interviews of any consideration for the elements of brand loyalty, brand awareness, perceived quality, brand associations or other proprietary brand assets which stimulate competitive advantage.

This is verified by Sinclair (2007) as well as Grobel and Forbes (2006) in assessments of IFRS 3 financial reporting of M&A transaction who confirm that goodwill is too high and mostly unexplained and that no insight is given to investors in documenting brand and other intangible asset values.

In support of IFRS 3 respondents 8 and 3 confirms there is another standard which is being developed, to be known as IAS38. It is expected to elaborate on financial accounting of intangible assets but is only expected in 2 to 3 years.

In addition there is a new stream of literature on customer equity currently developing which may complicate the corporate finance understanding of understanding value. The customer equity proponents suggest that customer equity creates the value in terms of customer lifetime value; which does not consider the brand which remains as the connection between customer interaction and the value being created.



6.2 ROLES OF CORPORATE ADVISORS.

There are three groups of M&A advisors who were contacted in terms of the research, namely:

- Corporate finance practitioners, which includes:
 - Bowman Gilfillan
 - Deloitte
 - Ernst and Young
 - Investec Bank
 - KPMG
 - PriceWaterhouseCoopers
- Brand agencies, which includes:
 - The Disruption Consultancy – which is a member of the worldwide TBWA and has affiliation to Brand Metrics
- Strategy consultants, which includes:
 - McKinsey Consulting
 - Brand Metrics
 - Burlington Corporate Strategy Advisors

The roles of the various role players above will be assessed subjectively against the contribution that could be made to the success of the merge based on six elements which could derail any M&A transaction.

A concern is that the categorisation of the respondents as described below is subjective and based on the interview responses attached in Appendix K1 to Appendix K10.



A second concern is that although the respondents generally represent global operations the discussions were generally of a local nature and therefore the comments are not representative in any way of the global operations.

Brunner (2005) describes six factors which can destroy a new firm in the course of M&A, which include:

- Destruction of market value – measured by a change in market share value.
- Financial instability – where the buyer over-extends his financial commitments through the purchase.
- Impaired strategic position – where strategic purpose of the merge is not achieved.
- Organisational weakness – relates to poor integration issues of the merging firms.
- Damaged reputation – the M&A transaction should improve reputation and not cause a conflict of identity between the new firm's publics.
- Violation of ethical norms and laws – causing corporate scandals which damage the integrity of the transaction.



6.2.1 THE ASSASSINS.

The corporate finance practitioners often refer to the company being purchased as the *target*. To extend this military metaphor one could consider their involvement in transactions as *assassins*.

The “assassins” approach M&A diligently and technically. Their roles are clear and purposeful. Their intentions are to discover the cash-flows and test its legitimacy in terms of the assumptions made to perform the calculations; to eliminate conflicts of interest and report their findings accurately.

Through the various forms of due diligence described above the role of the corporate advisor is generally limited as ultimate responsibility for the decisions and accountability for the valuation lies with the acquiring company.

The corporate advisors often are involved in providing accounting and auditing services to their clients. The auditing work is known as tier-one work, whilst the M&A activity such as transaction services, legal and tax advice is referred to as tier two work. Through the exploratory interviews it seems mostly that the corporate advisors do want to grow their suite of services, so it is not fitting that these roles and work functions suggest such a ranking of service.

Many of the respondents confirmed the volume of work is immense because of the growth in the M&A sector and in increasing governance and reporting requirements.



The corporate advisors are relatively constrained in terms of capacity and the environment is pressurised because of onerous confidentiality undertakings to avoid conflict of interest.

As shown in the research interviews and from the findings discussed above the “assassins” have a lower affiliation to brand. It is likely therefore that market share values and avoidance of reputation damage could receive less attention from this group. They would be very conscientious in terms of financial stability and maintaining ethical norms.

6.2.2 THE BRANDERS.

In contrast to the “assassins”, the brand agencies are less focussed on cash-flows. From the research interviews their focus is more on the “softer” touch-points of brand.

Their consideration is driven by advertising revenues and therefore the cash-flows that are generated by the company are less important than brand awareness scores or design elements of a billboard advertisement.

Their research is more qualitative in nature with the majority of brand metrics being consumer driven. Their impact can be very favourable as their approach is significantly more customer-centric.

The “branders” are very brand and marketing conscious and therefore it is likely that they would be only be better placed to improve market value and reduce reputation damage in a M&A transaction .



6.2.3 THE GENERALS.

Extending the military metaphor the “Generals” know what’s going on, but they don’t see as much action.

The strategic advisors who do not focus purely in the corporate finance market, or in the advertising industry seem to have some balance between the extremes described above. They have the ability to provide a credible brand valuation and their financial models are attached as Appendix H and Appendix I. They seem to have a longer term strategic approach and are less transactional in terms of the services they offer. They seem to be more concerned with integration issues post M&A. They have a deeper respect for the marketing concept of brand particularly because of the valuation of brand and intangible assets that they provide. The valuation approach is linked to longer term strategy and management of the brand performance as opposed to the “assassins” who would provide such a valuation purely to create a financial value of the M&A.

As all-rounders the “generals” are well placed to provide assistance, consulting advice and support during M&A. They are able to bring credibility to the valuation and therefore the cash-flows that are generated. Simultaneously this group is able to integrate strategy and marketing issues into the transaction to deliver better integration and culture fir results.

The “generals” are not likely to score low on any of the failure indicators proposed by Bruner (2005) and would therefore improve strategic positioning and in so doing remove organisational weakness.



6.3 IFRS 3 LEGISLATION IMPACT IN M&A.

McDonald and de Chartony (2001) describe a surge in intangibles worldwide due to intensified business competition and therefore the desire to create new basis for competitive advantage. Smith (2002) confirms that intangible assets, like brands, account for the bulk of corporate value, but are neglected in the planning of M&A's according to Heberden and Haigh (2006). Intangible assets represent close to 80% of the S&P 500 listed companies (Ettenson and Knowles, 2006) and according to respondent 10; after analysing M&A transactions in Europe, it was found that up to 70% of M&A sales value is attributed to the brand.

In general terms the accounting treatment of intangible assets is unfortunate. (Grobel and Forbes, 2006; Sinclair, 2007). IFRS 3 governs how intangible assets should be accounted for in business combinations (M&A) yet research in South Africa by Sinclair (2007) and in the UK by Grobel and Forbes (2006) confirms that goodwill is significantly overstated and therefore that no insight into the transaction is provided for investors.

A technical summary of IFRS 3 is attached as Appendix L.



IFRS 3 provides greater emphasis on transparency of acquisition accounting (Gobel and Forbes, 2006). IFRS 3 declares that when a business is sold, the details of the sale consideration should be transparent so that any residual value which exceeds the tangible asset value should not be accounted for as goodwill; or “the balancing number” referred to by interview respondents. The residual value should be identified and the intangible assets must be valued and accounted for within M&A according to Figure 4 adapted from Knowles (2007) and figure 5 from Thayser (2007).

In practice there are a number of factors which do not support adherence to IFRS in the strictest sense as follows:

- Corporate advisors confirm through the interviews that they are tasked by acquirers in terms of an initial scope to perform a due diligence review according to specific requirements. Often the intangibles do not form part of this scope and therefore as discussed by respondents 3 and 6 “due diligence is not about the intangibles.”
- There is an unintended incentive to maintaining goodwill as it is of a capital nature and therefore the tax rate applicable to capital gains of 14 ½ % is significantly more attractive than corporate tax rate of 29%.
- Respondent 8 confirms that brand valuation is in its infancy and that “the significance of IFRS3 and brand is being totally ignored by current practitioners.”
- Overpayments for a business will be highlighted. (Gobel and Forbes, 2006)



- Respondent 5 confirms “people want to attribute as little as possible to goodwill” as it affects the income statement negatively. Respondent 6 agrees that “as a consequence, people try and leave things in goodwill now to draw down the value of the intangibles because it hits your income statement. So, you’ve got this inconsistent treatment that in my view needs to be addressed by IFRS.”
- Increased levels of amortisation on certain asset classes might begin to affect the viability of a keenly priced transaction,
- Increased disclosure requirements lead to greater scrutiny from the financial and possibly competitor community

A due diligence checklist was supplied by one of the M&A corporate advisors as a guideline which is attached as Appendix C1. The majority of corporate advisors confirm that they do have some form of global methodology in terms of maintaining a standard approach to due diligence but that each assessment is unique and customised for the acquirer to address their unique scope regarding the M&A objectives sought.

Appendix D lists 89 intangible assets (Gobel and Forbes, 2006) which could be identified and valued in terms of IFRS 3. The checklist provided by the corporate advisor only specifically identifies 9 of the 89 items determined by IFRS.

IFRS 3 is therefore not providing transparency for business acquisitions as confirmed by the literature and expert interviews.



Chapter 7. CONCLUSION AND RECOMMENDATIONS.

7.1 CONCLUSION

In conclusion M&A activity in South Africa is extremely active with transaction values increasing year on year (Thayser, 2007). Generally there are three main role players in the market who have been identified as traditional corporate finance advisors, brand agencies and strategic advisors. Corporate advisors appear to be more transaction orientated to avoid conflict of interest and are by far the most active of the respondents interviewed in terms of volume.

Brand, and in particular the components of brand equity designed by Aaker (1991) of brand loyalty, brand awareness, perceived quality, brand associations and other proprietary brand assets are not formally considered by South African corporate advisors when due diligence is undertaken and therefore the elements of competitive advantage that brand equity creates are not officially evaluated. Informally the cash flows that are generated by brand activity are measured in due diligence activity and therefore by default the corporate brand is considered. The cash flows are therefore implicit of the brand activity according to the interviewed respondents.

According to Mahajan, Vithala and Rajendra (1994) the motivation for M&A is to enhance performance by increasing market share; to develop brand extension and corporate longevity into new markets and to develop carryover potential through extending successful brands.



However if the brand equity elements as well as the intangible assets that describe these motivations are not individually assessed by the majority of M&A corporate advisors, it implies that the inspiration for M&A activity may not be sustainable in achieving its intended objectives of incremental growth.

The impact of this activity and the fact that brand is not formally considered may affect the financial viability of M&A transactions. Conversely, when a marketing and brand orientation is followed success rates of M&A improve through customer retention and improved service quality perception to counter competitor actions (Homburg and Bucerius, 2005). Risk can be reduced through improved due diligence focussing on marketing assets (Perry and Herd, 2004; Mahajan *et al.*, 1994) as management are presented with unique opportunities to develop a persuasive vision for the new business (Ettenson and Knowles, 2006)

It seems that the IFRS 3 accounting standards originally designed to increase transparency and governance in M&A transactions (Grobel and Forbes, 2006) by providing more information to investors of business combinations is unfavourably affected.

According to Grobel and Forbes (2006) brand assets and intangible assets are not adequately reported on as originally intended by the introduction of IFRS 3, as goodwill is often presented in “all its meaningless glory.” Sinclair (2007, p. 1).



7.2 RECOMMENDATION TO STAKEHOLDERS

It is recommended that the following stakeholders might attain better performance levels in terms of M&A as follows:

7.2.1 ACQUIRERS

There is little doubt that brand performance is vital to the acquirers after the merge. Brand equity is a definite source of competitive advantage (Aaker, 1991) and contributes to improved customer retention and operational margins (Kotler and Keller, 2006).

Traditional due diligence is flawed as insufficient attention of key marketing strategy is disclosed (Gould, 1998; Clemente and Greenspan, 1996).

There are developments in terms of marketing due diligence (McDonald, Smith and Ward, 2006) and marketing metrics (Ambler, 2003) which draw attention to the inherent risks and measures of marketing. In the marketing due diligence process risk analysis is focussed on uncovering and quantifying market risk, share risk and profit risk as discussed in table 4. With such information, formally presented and accounted for, the intangible assets which are of a brand and marketing orientation would be understood and evaluated more comprehensively in terms IFRS 3 reporting convention.



Competitive advantage strategies, driven from the components of brand equity (Aaker, 1991) can therefore be fully incorporated against such a marketing due diligence as an agenda to reduce risk after the merge has occurred.

Tying such pre-deal findings into the post-deal operations is practical. (Hubbard *et al.*, 1994)

It is granted that not all M&A activity would justify such a marketing due diligence exercise which is dependant on the motivation for the merge and on the orientation of the brand and role-players involved in the transaction.

Where acquirers need to incorporate elements of culture and leadership which are critical to success (McGrady, 2005) into the transaction the current approach is insufficient as it is largely focussed on corporate finance, tax and legal elements of the merge.

Where acquirers need deeper understanding of the marketing and brand orientated risks then a marketing due diligence approach may be warranted.



7.2.2 SELLERS

As presented in table 2, the world's top brands have substantial value. The value is implicit in the brand according to the corporate finance advisors interviewed and therefore shareholders wishing to develop competitive advantage and enjoy a premium when sold in an M&A transaction should focus operational activities on improving the brand valuation.

Brand awareness and image strength are components of brand valuation as presented in the McKinsey model shown in Appendix H.

Presented in Appendix I the Brand Metrics model incorporates survey data to include a Brand Knowledge Structure score which is contrasted with competitors in the category that drives the Brand Premium Profit into the future and determines the brand expected life.

In their own rights these elements common in both valuation models are selected to incorporate competitor and brand image strength elements into the valuation because these elements are fundamental components of the brand strength and therefore implicit in improving competitive advantage and valuation of the firm.



It is therefore recommended that firms undertake a brand valuation exercise periodically to benchmark their own strategic performance in terms of brand strength and customer loyalty. With strategic emphasis and practical operational support the brand valuation may improve, creating further value for shareholders and consumers; as well as increasing the premium that may be negotiated if ever an offer to sell is considered.

7.2.3 CORPORATE ADVISORS

Most corporate advisors do consider brand within their due diligence approaches, but not directly.

They consider the cash-flows that are produced from the business activity and associate the cash flows with brand. They also associate these cash flows with all other income producing elements which could include management performance or even know-how.

In terms of the due diligence process the cash-flows emanating from the valuation are then tested in the due diligence process. The assumptions that have been made to generate the cash-flows are analysed. Although the business valuation might not change the underlying brand inputs driving performance should be recognised to be adequately reported on. Without a deeper understanding of the inherent source of the cash-flows the due diligence exercise is deficient in its findings.



It is therefore recommended that corporate advisors include more of a formal marketing due diligence offering into their suite of products to be able to adequately report on the brand equity drivers of competitive advantage.

It is confirmed by Grobel and Forbes (2006) and Sinclair (2007) that reporting in terms of IFRS is not achieving its transparency objectives.

Therefore a second motivation for the marketing due diligence approach is to evaluate and therefore incorporate marketing intangible assets into the reporting as required by IFRS 3 convention.

7.3 RECOMMENDATION FOR FUTURE RESEARCH

Future research could be directed at exploring and confirming some of the aspects highlighted.

Specifically the literature review points very strongly towards the incorporation of marketing and brand elements in M&A. The literature confirms that where brand is incorporated more formally and sooner in M&A activity that the rates of success might improve. This could be empirically tested for the South African market.

The literature review describes naming convention often adopted following a merge for the new entity to be created. The choices that are made and how these are strategically assessed from a South African perspective could be researched.



IFRS 3 reporting in terms of valuation and identification of intangible assets is relatively disappointing in South Africa as well as abroad. An analysis of the reporting, to track improvement if any, as well as the impact of new accounting standards (IAS38) could be undertaken for future research.

A case study of a prominent merger with strong consumer brand orientation could be undertaken to test the value of brand orientation in M&A activity.

A case study could be undertaken with selected corporate advisors where deeper introspection of the process followed, people involved, services offered and the clients involved could be undertaken to begin to develop a deeper understanding of the cash-flow assessment incorporated into the valuation process.

The measure of success in terms of M&A in South Africa is not clearly understood. It has certainly been reported on in financial terms for both the seller and acquirer, but often the motivation initially is not financially orientated. It may be to improve market shares, to improve distribution or to improve production capacity. All of these motivations will ultimately result in a financial measure of success, but the timelines for improvement may differ considerably. Research regarding the motivation would be useful to corporate advisors who could tailor their due diligence approaches accordingly.



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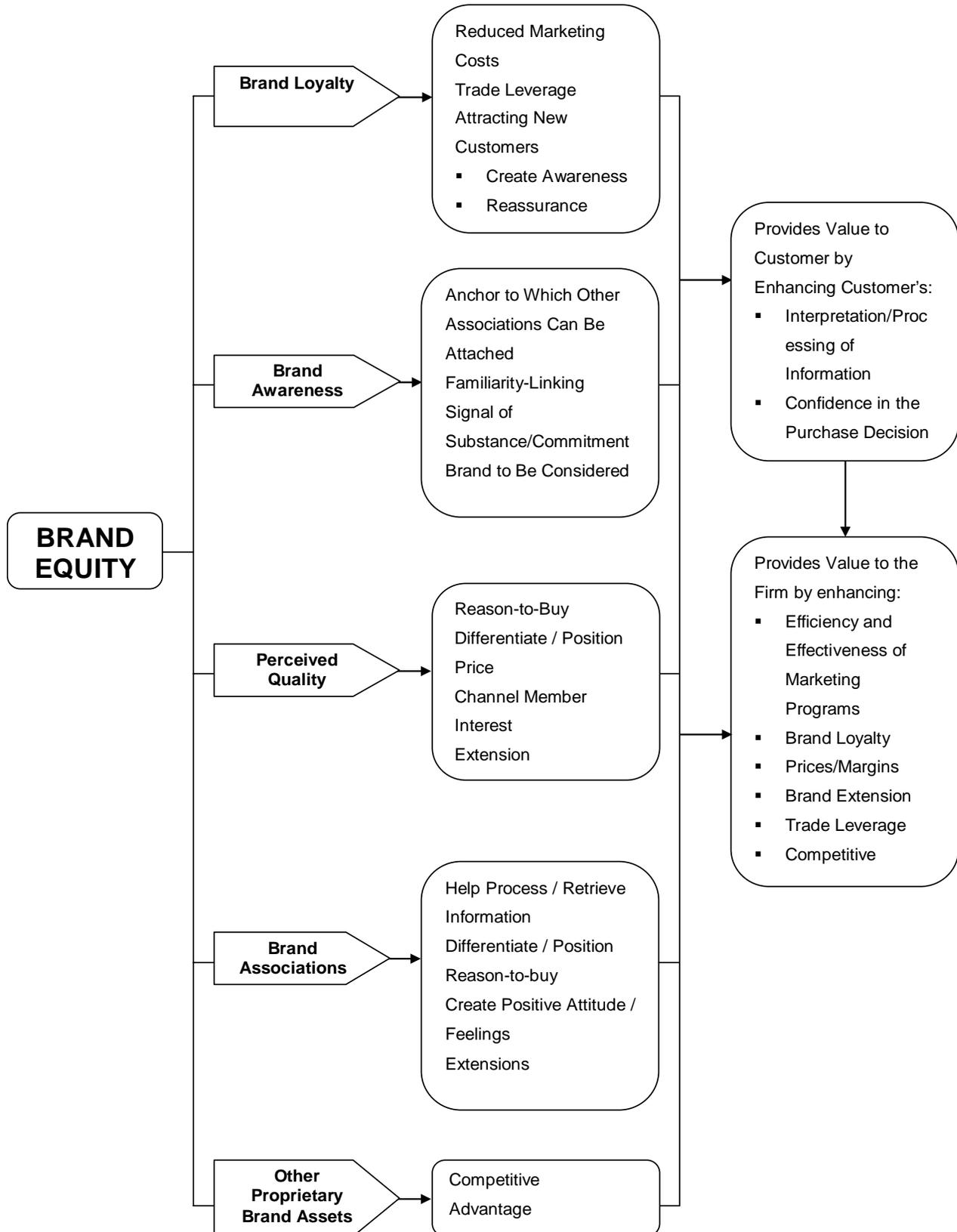


APPENDICES



APPENDIX A. COMPONENTS OF BRAND EQUITY

Adapted from Aaker (1991).





APPENDIX B. VARIOUS DEFINITIONS OF DUE DILIGENCE.

- The investigation and evaluation of a management team's characteristics, investment philosophy, and terms and conditions prior to committing capital to the fund.
www.ventureeconomics.com/vec/glossary.html
- Background check and research conducted by the factor to assess validity of a prospective factoring client and that client's customers.
www.factoring-company.us/factoring-glossary.html
- The verification of information and its documentation given to a factor in order to facilitate a decision as to whether or not a particular invoice should be purchased. Factors always want to take as little risk as possible and want to be assured that the money they advance will be paid back.
www.factorfunding.com/newsinfo/glossary.htm
- The process of gathering information about the condition and legal status of assets to be sold.
www.aaauctionservice.com/glossery_files/glossery.htm
- The degree of prudence that might be properly expected from a reasonable person in the circumstances; applicable to foundation personnel who act in a fiduciary capacity. (See Fiduciary Duty.)
www.yscf.org/glossary.html
- The analysis and appraisal of a business in preparation for a flotation or venture capital investment. Investors have a right to expect that these investigations are carried out thoroughly.
www.financingcp.org/glossary/glossary.html
- the degree of effort required by law that an unclaimed property holder must exert to find the rightful owner before the property is sent to the state. Usually this is in the form of an Owner Notification Letter.
www.maine.gov/treasurer/unclaimed_property/glossary/
- The use of extensive and documented procedures for collection of student loans, along with full and timely disclosure to borrowers of their rights and responsibilities. Minimum due diligence activities for collection of student loan debt is mandated by the federal government.
www.programs-safmt.org/Programs/contServ
- A process of inspection that a venture capital or other private equity firm carries out before closing on a deal. Venture capitalists, for example, might review a company's accounting practices and managerial structure.
www.wrhambrecht.com/ind/private/glossary/
- The process of systematically evaluating information, to identify risks and issues relating to a proposed transaction.(ie verify that information is what it is proposed to be).
strategis.ic.gc.ca/epic/internet/insof-sdf.nsf/en/so03149e.html



- The process of checking the accuracy of information contained in a company public statement, such as a prospectus, before recommending that company to others. Is also the act of one company investigating another company before buying its shares.
<https://www.shareanalysis.com/asp/glossary.asp>
- Implementing security policies and the mechanisms that support them demonstrates due diligence. The security mechanisms are continually maintained and operational. If an organization does not practice due diligence pertaining to the security of its assets it can be legally liable for negligence and held accountable for the ramifications of that negligence.
www.michigan.gov/cybersecurity/0,1607,7-217-34415---,00.html
- The process of reviewing and analysing in detail the capacity of a bidding organisation to meet future contract performance requirements. This may include a detailed assessment of the organisation's financial stability, legal risks, technical capacity, and infrastructure.
www.vgpb.vic.gov.au/CA256C450016850B/0/073B1893942AC1C9CA256C5C0006AC1D
- (a form of research)
www.1000ventures.com/doc/glossary_bt.html
- An investigation of a company that is preparing to go public.
www.scsecurities.org/glossary.html
- Investigations undertaken to assess the strength of one or more intellectual property rights.
www.novagraaf-intellectual-property.co.uk/glossary.htm
- A reasonable investigation conducted by the parties involved in preparing a disclosure document to form a basis for believing that the statements contained therein are true and that no material facts are omitted.
personal.fidelity.com/products/stocks_bonds/content/ipoglossary.html
- A legal requirement that stock brokers, underwriters and spin-off sponsors must meet to ensure that the statements made by a spin-off company or public company are accurate and complete. The purpose is to ensure the public has full and accurate information about a public company or a private company about to become a public company.
www.going-global.com/equity/finance-glossary.html
- In an offering of securities, certain parties who are responsible for the accuracy of the offering document, have an obligation to perform a "due diligence" examination of the issuer; issuer's counsel, underwriter of the security, brokerage firm handling the sale of the security. Due diligence refers to the degree of prudence that might properly be expected from a reasonable man, on the basis of the significant facts which relate to a specific case.
www.maverickenergy.com/lexicon2.htm
- The Customer must accurately describe the economic origin of the assets as requested by the Company that he/she will transfer on his/her bank account. This information



should be given to evidence due diligence of the Customer, and is kept strictly confidential. The Customer agrees also to fully disclose the beneficial owner of the assets if it is a third party. The Client has to give proof of his/her identity as requested by the company.

www.swiss-bankaccount.com/termsandconditions.html

- An internal analysis by a lender, such as a bank, of existing debts owed by a borrower in order to identify or re-evaluate the risk. An independent analysis of the current financial state and future prospects of a company in anticipation of a major investment of venture capital or a stock-exchange flotation. A Venture Capitalist firm's examination by its lawyers and auditors of the records, accounts and any legal documents of an existing business.
www.promitheas.com/glossary.php
- the performance of those actions that are generally regarded as prudent, responsible and necessary to conduct a thorough and objective investigation, review and/or analysis. In the thrift industry, the term is used to describe the preacquisition analysis of a savings association by a potential acquirer. The analysis includes a review of the institution's franchise value, an identification of its assets and liabilities, an evaluation of its management, and a determination of its purchase price.
www.ots.treas.gov/glossary/gloss-d.html
- The process whereby an investor investigates the attractiveness of an opportunity, assesses the quality of the management team, and assesses the key risks associated with and opportunity. Due diligence starts on initial inspection of an opportunity and ends when the investment is in the investee's bank.
www.tvp.com.au/resources/glossary.htm
- Investigation conducted by Underwriters and their counsel and, in some cases also by bond counsel and Issuer's counsel to determine whether all material items in connection with the Issuer, the Issue and the security for the Issue have been accurately disclosed in the Official Statement (or if a Private Placement in the Placement Memorandum) and that no material disclosure has been omitted.
www.indygov.org/eGov/City/BondBank/glossary.htm
- Documented collection procedures used by lenders and servicers to resolve a delinquent account and prevent a default. These procedures are dictated by federal regulations.
www.ppslc.com/glossary.php
- Due diligence is the effort a party makes to avoid harm to another party. Failure to make this effort is considered negligence. Quite often a contract will specify that a party is obligated to provide due diligence.
en.wikipedia.org/wiki/Due_diligence



APPENDIX C. GENERIC SAMPLE DUE DILIGENCE CHECKLIST.

I. Financial Information

A. Annual and quarterly financial information for the past three years

1. Income statements, balance sheets, cash flows, and footnotes
2. Planned versus actual results
3. Management financial reports
4. Breakdown of sales and gross profits by:
 - a. Product Type
 - b. Channel
 - c. Geography
5. Current backlog by customer (if any)
6. Accounts receivable aging schedule

B. Financial Projections

1. Quarterly financial projections for the next three fiscal years
 - a. Revenue by product type, customers, and channel
 - b. Full income statements, balance sheets, cash
2. Major growth drivers and prospects
3. Predictability of business
4. Risks attendant to foreign operations (e.g., exchange rate fluctuation, government instability)
5. Industry and company pricing policies
6. Economic assumptions underlying projections (different scenarios based on price and market fluctuations)
7. Explanation of projected capital expenditures, depreciation, and working capital arrangements
8. External financing arrangement assumption

C. Capital Structure

1. Current shares outstanding
2. List of all stockholders with shareholdings, options, warrants, or notes
3. Schedule of all options, warrants, rights, and any other potentially dilutive securities with exercise prices and vesting provisions.
4. Summary of all debt instruments/bank lines with key terms and conditions
5. Off balance sheet liabilities

D. Other financial information



1. Summary of current federal, state and foreign tax positions, including net operating loss carryforwards
2. Discuss general accounting policies (revenue recognition, etc.)
3. Schedule of financing history for equity, warrants, and debt (date, investors, dollar investment, percentage ownership, implied valuation and current basis for each round)

II. Products

A. Description of each product

1. Major customers and applications
2. Historical and projected growth rates
3. Market share
4. Speed and nature of technological change
5. Timing of new products, product enhancements
6. Cost structure and profitability

III. Customer Information

A. List of top 15 customers for the past two fiscal years and current year-to-date by application

(name, contact name, address, phone number, product(s) owned, and timing of purchase(s))

B. List of strategic relationships

(name, contact name, phone number, revenue contribution, marketing agreements)

C. Revenue by customer

(name, contact name, phone number for any accounting for 5 percent or more of revenue)

D. Brief description of any significant relationships severed within the last two years.

(name, contact name, phone number)

E. List of top 10 suppliers for the past two fiscal years and current year-to-date with contact

information

(name, contact name, phone number, purchase amounts, supplier agreements)

IV. Competition

A. Description of the competitive landscape within each market segment including:

1. Market position and related strengths and weaknesses as perceived in the market place



-
2. Basis of competition (e.g., price, service, technology, distribution)

V. Marketing, Sales, and Distribution

A. Strategy and implementation

1. Discussion of domestic and international distribution channels
2. Positioning of the Company and its products
3. Marketing opportunities/marketing risks
4. Description of marketing programs and examples of recent marketing/product/public relations/media information on the Company

B. Major Customers

1. Status and trends of relationships
2. Prospects for future growth and development
3. Pipeline analysis

C. Principal avenues for generating new business

D. Sales force productivity model

1. Compensation
2. Quota Average
3. Sales Cycle
4. Plan for New Hires

E. Ability to implement marketing plan with current and projected budgets

VI. Research and Development

A. Description of R&D organization

1. Strategy
2. Key Personnel
3. Major Activities

B. New Product Pipeline

1. Status and Timing
2. Cost of Development
3. Critical Technology Necessary for Implementation
4. Risks

VII. Management and Personnel

A. Organization Chart



- B. Historical and projected headcount by function and location
- C. Summary biographies of senior management, including employment history, age, service with the Company, years in current position
- D. Compensation arrangements
 - 1. Copies (or summaries) of key employment agreements
 - 2. Benefit plans
- E. Discussion of incentive stock plans
- F. Significant employee relations problems, past or present
- G. Personnel Turnover
 - 1. Data for the last two years
 - 2. Benefit plans

VIII. Legal and Related Matters

- A. Pending lawsuits against the Company
(detail on claimant, claimed damages, brief history, status, anticipated outcome, and name of the Company's counsel)
- B. Pending lawsuits initiated by Company
(detail on defendant, claimed damages, brief history, status, anticipated outcome, and name of Company's counsel)
- C. Description of environmental and employee safety issues and liabilities
 - 1. Safety precautions
 - 2. New regulations and their consequences
- D. List of material patents, copyrights, licenses, and trademarks
(issued and pending)
- E. Summary of insurance coverage/any material exposures
- F. Summary of material contacts
- G. History of SEC or other regulatory agency problem, if any



APPENDIX C1. M&A RESPONDENT SAMPLE DUE DILIGENCE CHECKLIST.

This due diligence checklist was supplied by one of the M&A corporate advisors. Appendix D which follows, lists 89 intangible assets which could be identified and valued in terms of IFRS 3. The checklist below mentions intangible assets broadly however only specifically identifies 9 of the 89 determined by IFRS.

1. Target Profile

Introduction

- Statutory framework – Organogram
- Details of any acquisitions or disposals of companies or businesses or discontinued operations and details of any proposals for such transactions
- Details of any *Joint Ventures*, partnerships or similar arrangements
- Details of any affiliations, alliances, etc.
- Details of *locations* and nature of operations in each location

2. History and Business

- Brief description of history of target
- Brief description of the target's operations, activities, products and/or services, processes, etc.
- *Products*
- Overview
- Details of product warranty policies, claims history, reciprocal warranties from suppliers & basis of providing for future liability



Distribution

- Overview
- Principal ***distribution methods***
- Terms of trade, discounts, rebates, etc.
- Sales incentives

Customers

- Customer base concentration
- ***Key customers and contractual arrangements.***

Suppliers

- Main vendors/***suppliers; purchase contracts*** and commitments.

Market segmentation

- Turnover by principal customers
- Turnover by main product categories
- Turnover by region

3. Financial

3.1 Accounting policies

- Details and assessment of principal accounting policies & disclosures
- Appropriateness
- Consistency in application of policies
- Details of any changes in accounting policies in recent years

3.2 Trading Results (for the past 2 audited years and the latest management accounts)



3.3 Overview

- Summary of results
- Summarised income statement, preparation of range of ratios & explanation of significant fluctuations/variations

3.4 Commentary on:

- Turnover – analysis of turnover by business segment, geographic regions, major customers, seasons & other appropriate categories
- Gross profit
- ***Significant accounts***
- Overhead analysis split by category of expense and preparation of a range of ratios
- Analysis of financing costs
- Foreign exchange
- Details of exchange gains and losses
- Fees and other payments to shareholders
- Details of extraordinary and abnormal items, including accounting treatment and appropriateness thereof
- Non-recurring revenue and extraordinary expenditure
- Adjusted EBIT including analysis of non-recurring revenue or costs, lost customers, accounting policy changes, other.

3.5 Assets and liabilities (for the past 2 audited years and the latest management accounts)

- Overview
- Analysis of key accounts in the financial statements
- Summary of balance sheets
- Fixed assets (detailed analysis, review fixed asset register, details of depreciation, policy and rates, details of replacement and maintenance policy)
- In-house Developed Software
- ***Intangible assets and intellectual property*** (whether capitalised or expensed, including basis of their valuations)
- Investments
- Deferred expenditure (Basis of capitalisation & amortisation)
- Stock



-
- Debtors
 - Cash
 - Other material current assets
 - Creditors
 - Overdraft (including details of facilities as well as terms and conditions applicable)
 - Details of significant amounts due to/by the Receiver of Revenue
 - Other material current liabilities
 - Extent of provisioning (analysis of various provisions & movements in provisions)
 - Director's loans
 - Long-term liabilities (detailed analysis, details of terms and conditions, review of loan agreements for financial implications, comparison of shareholders' loans and movements in balances)
 - Other equity accounts
 - Details of encumbered assets
 - Assets not owned e.g. tooling
 - Maintenance agreements
 - Warranties

 - Finance (details of facilities available [terms, security, interest rates, review dates], indication of facilities used during the year, factoring agreements, details of finance leases [terms, security, interest rates, review dates])
 - Contingent liabilities
 - Guarantees issued by or on behalf of target
 - Capital commitments
 - Forecast capital expenditure

4. Forecast 2005

- Review of assumptions underlying forecast
- Comment on expected outturn based on historical performance achieved (2003, 2004)



5. Human Resources

- Functional and line management charts for key functions.
- Remuneration of key management.
- Pension fund - qualifying criteria
- Financial details (adequacy of funding)
- Succession planning
- Staff turnover / ***employment contracts***
- Details of liability for post retirement benefits (particularly medical aid) and extent to which provision has been made

6. Information Technology

- Brief overview and assessment of accounting computer installation and systems
- Discussion with auditors regarding controls
- Adequacy of financial reporting systems
- Review of management letters
- Discussion with management



APPENDIX D. LIST OF INTANGIBLE ASSETS AND INTELLECTUAL PROPERTIES.

Information adapted from Grobel and Forbes (2006).

There are 89 items listed.

Airport gates and slots	Film libraries	Procedural manuals
Bank customers deposits, loan, trust and credit card	Food flavorings & recipes	Production backlogs
Blueprints	Franchise agreements	Product designs
Book libraries	Historical documents	Property use rights
Brand names	HMO enrollment lists	Proposals outstanding
Broadcast licenses	Insurance expirations	Proprietary computer Software
Buy sell agreements	Insurance in force	Proprietary processes
Certificates of need	Joint ventures	Proprietary products
Chemical formulas	Know-how	Proprietary technology
Computer software	Laboratory notebooks	Publications
Computerized databases	Landing rights	Retail shelf space
Contracts	Leasehold interests	Royalty agreements
Cooperative agreements	Literary works	Schematics & diagrams
Copyrights	Loan portfolios	Securities portfolios
Credit information files	Location value	Security interests
Customer contracts	Management contracts	Shareholder agreements
Customer & client lists	Manual databases Manuscripts	Solicitation rights



Customer relationships	Medical charts and records	Stock & bond instruments
Designs & drawings	Mineral rights	Subscription lists
Development rights	Musical compositions	Supplier contracts
Distribution networks	Natural resources	Technical & specialty Libraries
Distribution rights	Newspaper morgue files	Technical documentation
Drilling rights	Non compete covenants	Technology sharing agreements
Easements	Options, warrants, grants, rights	Title plants
Employment contracts	Patent applications	Trade secrets
Engineering drawings	Patents both product & process	Trained & assembled workforce
Environmental rights	Patterns	Trademark and trade names
FCC licenses	Permits	Training manuals
Favorable financing	Prescription drug files	Use rights air, water, land
Favorable leases	Prizes and awards	



APPENDIX E. CORPORATE ADVISORS RECORDED FOR 2005 AND 2006 M&A ACTIVITY.

Information analysed and presented from E&Y data of M&A activity

ABSA Corporate & Merchant Bank - Corporate Finance	FCF Capital	Nedbank Capital
Africa Vukani Investment Management Services	Fieldstone Africa (Pty) Ltd	NewFound
AMBCAPITAL Corporate Finance	First Africa	Ngcebetsha Madlanga
andisa	Fisher Hoffman PKF (Jhb) Inc.	Nucleus
ANZ Investment Bank	Frankel Consulting	Pan African Advisory Services
Arcay Group Ltd	Gandalf Trust	PKF Accountants & business advisers
Barclays Capital	Goldman Sachs	PricewaterhouseCoopers Corporate Finance (Pty) Ltd
Barnard Jacobs Mellet Corporate Finance (Pty) Ltd	Grant Thornton Corporate Finance (Pty) Ltd	PSG Capital Ltd
BDO QuestCo (Pty) Ltd	Grindrod Bank	QuestCo (Pty) Ltd
BDO Spencer Steward Capital (Pty) Ltd	HJS Advisory Services (Pty) Ltd	Rabin & Associates
BEEExchange Advisors	Horwath Leveton Boner	Radagast Capital (Pty) Ltd
Bishop Corporate Finance (Pty) Ltd	HSBC	Rand Merchant Bank - A division of FirstRand Bank Ltd
Blackstar Managers	Ian Dry	RBC Capital Markets
BMO Nesbitt Burns	icapital advisers	River Group



Brait Advisory Services Ltd	Imara Corporate Finance	RMB Corvest
bravura	Investec Bank Ltd	Rothschild
Bridge Capital	JAVACAPITAL	Sansara
Bright Equity	JAVELIN CAPITAL LIMITED	Sasfin Corporate Finance - A Division of Sasfin Bank Ltd
Cadiz corporate Solutions	JP Morgan	SizweNtsaluba vsp Corporate Finance (Pty) Ltd
Centric Capital Ventures LLC	Khumo Bathong Capital	Spirit
Chartwell Capital Group	KPMG	Spirit Capital
Circle Capital	Lanark Financial Services	Standard Bank
Citigroup	Longcross	T Corp
Cohen Hill Funk & Co	Lyons Financial Solutions (Pty) Ltd	Thebe Business Ownership Plans
Coronation Capital Ltd	Marriott Corporate Property Bank	UBS Corporate Finance South Africa (Pty) Ltd
Corporate and Merchant Advisors Ltd	Masazane	UBS South Africa (Pty) Ltd
Decillion	Merchantec Corporate Finance	Utho Capital (Pty) Ltd
Deloitte Corporate Finance Division	Merrill Lynch South Africa (Pty) Ltd	Venmyn Rand (Pty) Ltd
Deutsche Securities SA (Pty) Ltd	Metier	Vuvsni Capital Ltd
Dresdner Kleinwort Wasserstein	Moores Rowland	Whiteley Rose Herbst Corporate Advisors
Ernst & Young Corporate Finance (Pty) Ltd	Morgan Stanley	Wipcapital (Pty) Ltd



APPENDIX F. QUESTIONNAIRE GUIDELINE

Mergers and Acquisition questions

- What services are generally offered by corporate advisors during M&A?
- What is the current process followed during M&A by the top consulting corporate finance advisors?
- What is important to the client in this process to ensure value is maintained or improved in the transaction?
- What consideration is given to the new entity and its brand profile which will result after the M&A, and if any, when does this occur in the process?

Brand equity questions

- How is brand valued in M&A transactions?
- If valued individually, what is brand valuation in relation to the remaining value of the business?
- Is the brand valuation refutable or generally accepted?

Marketing audit / due diligence questions

- What is generally included in a typical due diligence process?
- Is a marketing audit or due diligence done before the M&A process?
- If not – could it be a valuable inclusion to quantify brand growth?
- If not, what are the reasons for its exclusions?

Intangible assets questions

- How are intangible assets valued and verified in a typical M&A transaction?
- What are the typical elements of intangibles in SA?
- What is the expectation for the new “owner” of these intangibles in creating value in the new entity?



APPENDIX G. BRANDMETRICS MODEL TO CALCULATE BRAND VALUE.

The method in outline

The BrandMetrics originators were able to bring together two different brand variables: finance and marketing. In the model these are linked mathematically to produce values that capture the brand's financial performance and its relationship with its user group.

Discounting an asset's forecast earnings to present value (DCF) is standard valuation practice but is usually conducted over short periods of time. The BrandMetrics approach recognises that brands are long-lived assets and that they will generate earnings for many years into the future. The number of years in the model is to a large extent a function of the relationship between the brand and its loyal users. The stronger the relationship, the more years there are in the model, and the more valuable is the brand. Naturally the opposite is equally true and the model deals with this as well.

The method uses DCF but drives forecasts into the future using a unique approach. The expected life of a truly great brand can be as long as 50 years and more. Contrary to common wisdom, using a low discount rate, there is still value to be gained after this length of time. The BrandMetrics technique ensures this distant value is not lost.

The methodology requires four core inputs:

Financial: Net operating profit after tax; capital employed, a cost of capital and management forecasts for between one and three years.

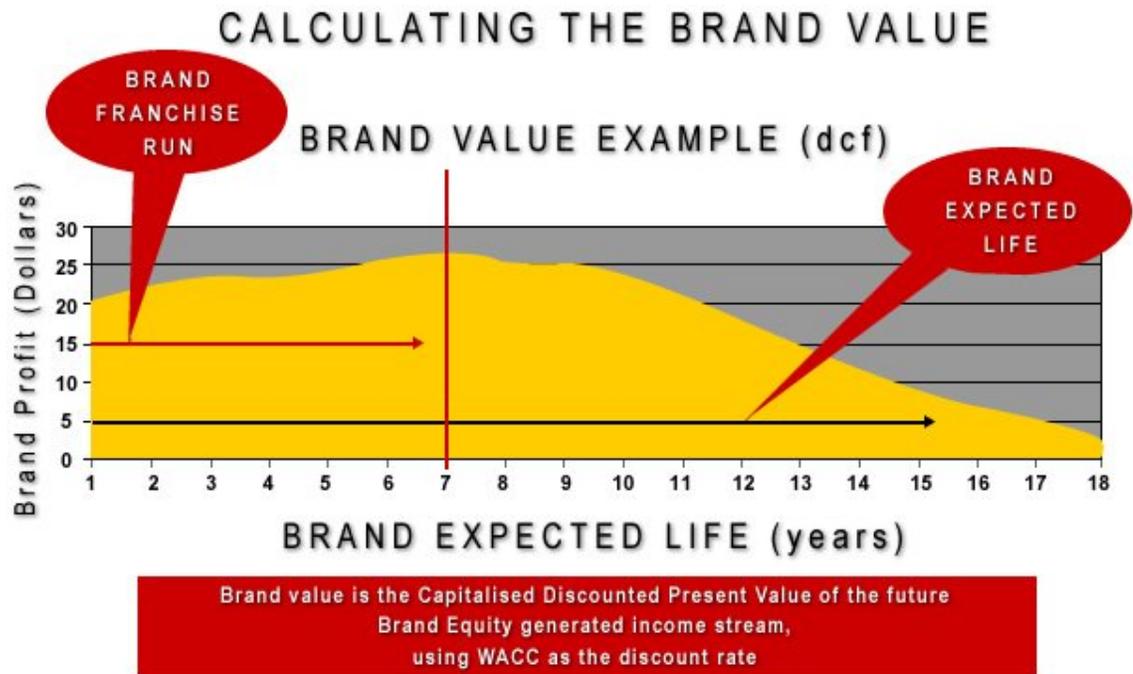
Category expected life. A device developed by BrandMetrics is used to calculate the expected life for the category in which the brand sells. This process sets time markers for the valuation and dictates the shape of the DCF slope.

Dilution. A specially developed approach using a modification to the famous Delphi forecasting technique is used to work out the percentage of the brand's value added profits that are directly attributable to the brand.

Brand Knowledge Structure (BKS). Drawing on survey data, a Brand Knowledge Structure score out of 100 is calculated. It is this score, contrasted with competitors in the category that drives the Brand Premium Profit into the future and determines the brand expected life.

Once the data is accumulated it is simply typed into the screens in the specially created and secure BrandMetrics web site. A report at the end provides the valuation and key information. Once the original valuation is locked cloned versions can be created in order to estimate sensitivities and test the effect of changes to the variables.

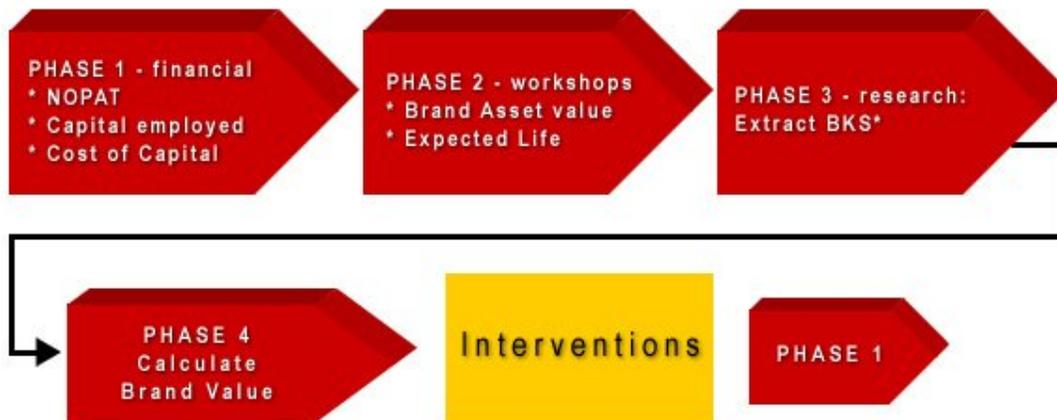
Graphical depictions of the model



The shape depicts the full Brand Premium Profit projection for a hypothetical brand. The Franchise Run is the period that is influenced by the brand relationship and in this example is seven years. Based on this and other variables the Decay Phase is calculated to capture, in this instance, nineteen years expected life. These future premium profits are discounted to present value using the Cost of Capital as the discount rate. The capitalised result is the brand value.

THE FOUR PHASE PROCESS

Steps taken to value a brand

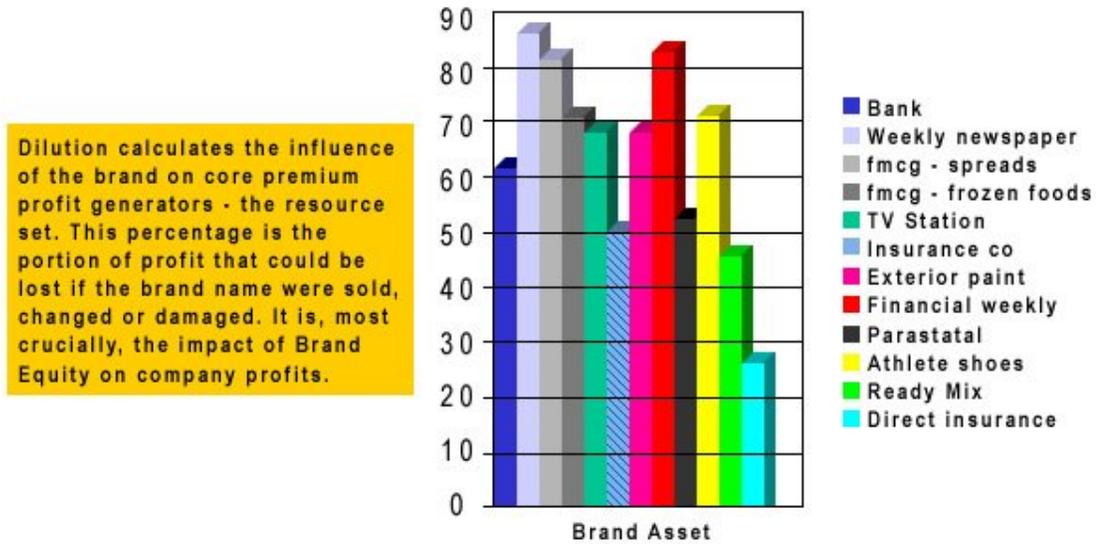


BKS* = Brand Knowledge Structure



In this table a selection of dilution percentages for current clients in a variety of industries are shown. When applied to the economic profit, the portion attributable to the brand is isolated.

IMPLICATIONS OF DILUTION



Copyright

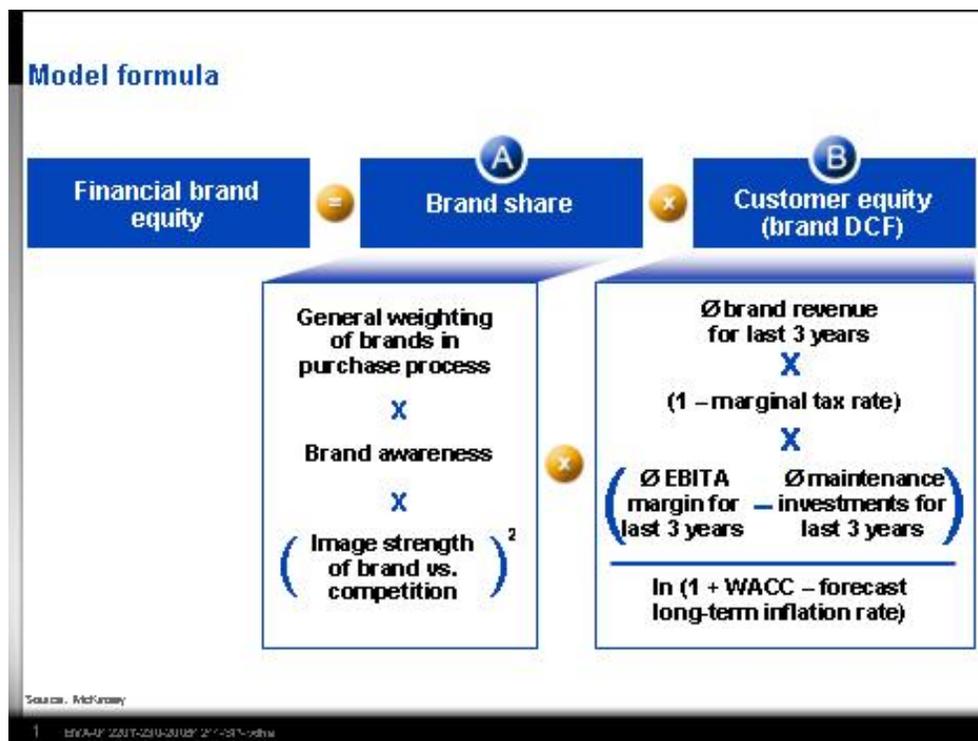
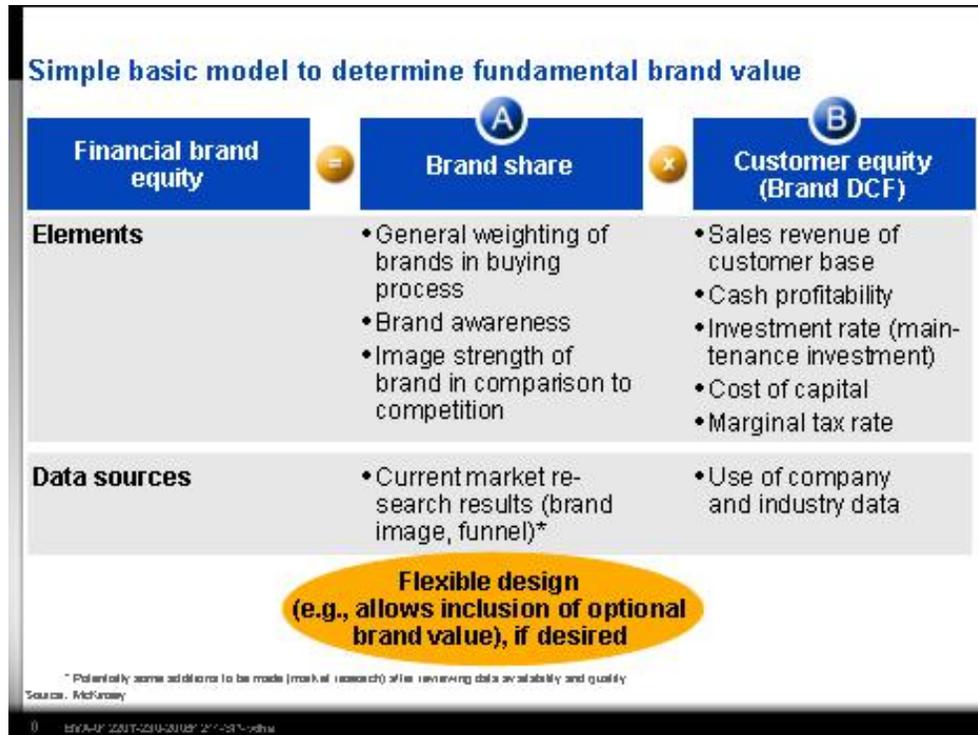
Your attention is drawn to the fact that the works contained herein are original and that the copyright subsists with BrandMetrics and its partners.

Authorised permission has been obtained from BrandMetrics and the authors of the model presented above.



APPENDIX H. MCKINSEY MODEL TO CALCULATE BRAND VALUE

Provided by: Dr Tjark Freund of Mckinsey & Company, Hamburg, Germany.



A Determining the brand share factor

Brand as a share of customer equity*

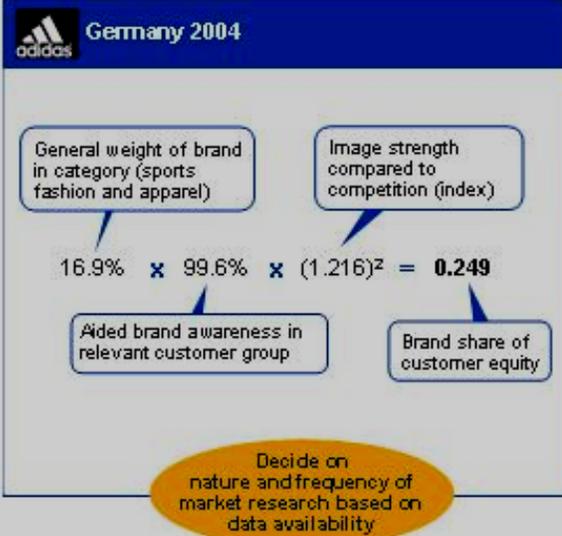
General weighting of brands in purchase process

X

Brand awareness

X

(Image strength of brand vs. competition)²



* Formula (e.g., ageing) derived from model calculations with the highest statistical information value
Source: McKinsey

B Determining the customer equity factor

Customer equity

∅ brand revenue for last 3 years

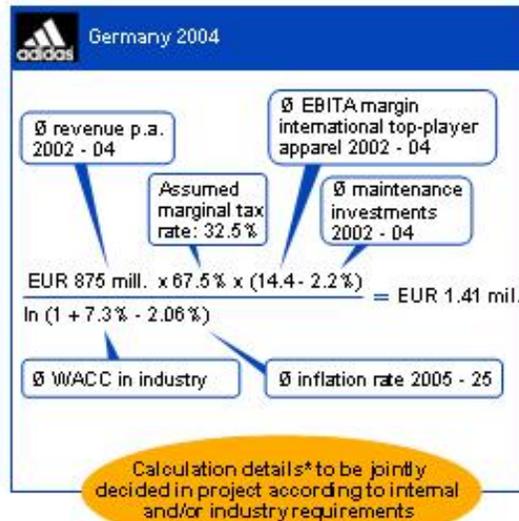
X

(1 - marginal tax rate)

X

(∅ EBITA margin for last 3 years - ∅ maintenance investments for last 3 years)

In (1 + WACC - forecast long-term inflation rate)



* (i.e., number of rolling years (2 vs. 3 years), EBITA reference group (top-players vs. industry average))
Source: McKinsey



APPENDIX I. TOP 10 M&A TRANSACTIONS BY VALUE FOR 2005 AND 2006

This table was created by the author from the M&A data supplied by E&Y. The list is ranked in terms of the value of the transaction from highest value to lowest.

Table 15 – Top 10 M&A transactions by value for 2005 and 2006.

Compiled and analysed by author from M&A data obtained from E&Y database

Acquirer	Target	Effective Date	Seller	Value (R – Million)	Feature
OLD MUTUAL PLC	Forsakrings aktiebolaget Skandia	Feb-06	Shareholders	38,000	Merger of Related Businesses
Description: Acquisition of Swedish savings group.					
MTN Group Ltd	Investcom LLC	May-06	Undisclosed	33,500	Outward Investment
Description: Acquisition of 100% interest of company listed in Dubai and London					
Vodafone Group Plc	VENFIN LTD - B ordinary shares	Nov-05	Rembrandt Trust (Pty) Ltd	16,000	Acquisition of Related Business
Description: Offer to acquire 35,5 million B ordinary shares					
Barclays Bank Plc	ABSA GROUP LTD	Jul-05	Shareholders	14,379	Acquisition of Related Business
Description: Acquisition of up to 60 % of Absa ordinary shares effected by an inter-conditional 32 % scheme of arrangement and 28 % partial offer / Increase in interest to 56.4 % (30 September 2005).					
Brait	Shoprite Holdings Ltd	Nov-06	Undisclosed	14,200	S228
Description: Acquisition of Shoprite Holdings by Brait Private Equity					
Shareholders	Kumba Iron Ore	Oct-05	KUMBA RESOURCES LTD	14,000	Unbundling
Description: Unbundling by way of a dividend or payment under section 90 of the South African Companies Act / Simultaneous listing of Kumba Iron Ore.					



Acquirer	Target	Effective Date	Seller	Value (R – Million)	Feature
Anglo American plc	Anglo American plc	Mar-06	Shareholders	12,660	Share buy-back
Description: Buyback of \$2billion worth of shares					
Network Healthcare Holdings Ltd	General Healthcare Group Ltd	May-06	BC Partners Ltd	12,466	Outward Investment
Description: Acquisition of a controlling stake in the leading private Hospital operator in the United Kingdom					
Undisclosed	Gold Fields Ltd	Mar-06	Polyus	12,394	Disinvest by Foreign Company
Description: Sale of entire stake by Russia's largest gold producer					
Royal Bafokeng Nation	Impala Platinum Holdings Ltd	Sep-06	Impala Platinum Holdings Ltd	12,100	Black Economic Empowerment
Description: The Royal Bafokeng Nation has converted its 22% royalty on the pre-tax earnings of The Impala Lease Area into a 13.4% stake in Implats					



APPENDIX J. M&A ACTIVITY BY FEATURE / MOTIVATION

The table was created by the author from analysis of M&A data provided by E&Y. The list is sorted alphabetically in terms of feature.

Table 16 – M&A Activity by feature / motivation for 2005 and 2006.

Feature	2005		2006		Total Value (R Mio)	Total Count
	Value (R Mio)	Count	Value (R Mio)	Count		
Acquisition of Related Business	92,520	439	36,740	325	129,260	764
Black Economic Empowerment	8,352	153	45,715	215	54,067	368
Buy in as Partner	-	2			-	2
Buyout of Minorities	84	12	28	1	112	13
Cash Shell Acquisition	155	3			155	3
Cash Shell Creation	3	2			3	2
Conditional Offer	44,089	131	-	-	44,089	131
Contested transaction	-	-	6,409	2	6,409	2
Contingent Pricing - Earn Out Element	8	1	447	1	456	2
Contingent Pricing - Payment in Installments	1,726	20	677	4	2,403	24
Contingent Pricing - Price Subject to Audit	2,266	11	279	1	2,545	12
Contingent Pricing - Subject to Profit Warranty	3,082	20	255	4	3,337	24
Disinvest by Foreign Company	4,058	9	26,065	12	30,124	21
Disinvest in Foreign Company by Local Company	1,734	14	3,156	14	4,890	28
Distribution in Shareholding	1,162	2			1,162	2
Exercise of option	1,173	2	515	4	1,688	6
Fair & Reasonable Opinion	312	4	1,769	7	2,081	11
Formation of Joint Venture	429	75	3,105	100	3,534	175
Formation of Partnership	50	23	-	9	50	32
Group Reconstruction	1,543	5	11	3	1,554	8
Hostile Takeover	805	1			805	1
Independent expert	362	1	12	2	374	3
Investment in South Africa by Foreign Company	8,126	17	10,461	40	18,587	57



Feature	2005		2006		Total Value (R Mio)	Total Count
	Value (R Mio)	Count	Value (R Mio)	Count		
Issue for Cash	164	11			164	11
Management Buyout (MBO)	40	4	-	2	40	6
Members Voluntary Winding-Up	190	1			190	1
Merger of Related Businesses	46,177	39	1,094	27	47,271	66
Offer to Minorities in terms of Code	0	4	2,321	6	2,321	10
Other	11,722	138	10,338	93	22,060	231
Outward Investment	-	3	61,598	65	61,598	68
Private Equity			681	10	681	10
Public Tender for Shares	2,492	5	-	-	2,492	5
Reverse Takeover	618	5	211	2	828	7
S228	-	-	14,203	2	14,203	2
S311 Scheme & Delisting	3,573	10	10,115	4	13,688	14
S440K Acquisition of Minorities & Delisting	40	3	3,872	3	3,912	6
Section 311 Scheme of Arrangement	8,045	14	20,799	8	28,844	22
Section 60 Tax Act Distribution in Specie	-	1			-	1
Share buy-back	5,836	38	21,398	32	27,233	70
Strategic Alliance	-	8	-	11	-	19
Subject to Competition Commission approval	119	3	377	6	495	9
Subject to Due Diligence Investigation	0	2	44	4	44	6
Unbundling	17,658	4	908	3	18,566	7
Unconditional Offer for Shares	831	3			831	3
Grand Total	269,543	1,243	283,603	1,022	553,146	2,265



APPENDIX K. RESEARCH INTERVIEW – KEY TO THEMES

Emerging from the research interviews, through discussion, exploration and cross referencing a number of common themes began to surface. The actual discussions have been highlighted according to these frequent themes as follows:

Colour description	Theme description
	Brand is generally an afterthought.
	You're not registered for popcorn.
	Due diligence is actually about.
	It's a huge conflict of interest.
	The value we bring to the table is – discussed in Services section of Chapter 5.
	IFRS 3 is a balancing act.



APPENDIX K1. RESEARCH INTERVIEW – RESPONDENT 1.

CB - I've chosen the idea of mergers & acquisitions for my thesis for my MBA – and would like to discuss the role that brand plays in mergers & acquisitions, for two reasons - the first is there have been some recent changes in legislation, in about 2005 in terms of accounting legislation which says that when a company is bought, up until now, what the auditors and accountants used to do is they use to say here's the selling price – that's actually the value of the business in terms of assets that we can touch and find and all the rest, and the rest is essentially goodwill – and we write it up to goodwill in terms of what was paid for the business. This new legislation that's come in and I'm really simplifying it, in terms of IFRS International Financial Reporting Standards, it says the extra balance you have as goodwill must be reduced to actual intangible assets – where you can find them, where you can value them and in terms of your valuation methodology, put a value on those items – and they're all intangible assets, things we can't necessarily touch and feel – like brands, trademarks, copyrights, patents, even R&D in some instances, might be some advance payments in terms of R&D, so that investors, shareholders and all these guys who are involved in these kind of transactions can see what was paid for the business and see how its made up in terms of its components.

So that's the first reason why I'm looking at it – to see if its done and if it is, how you do it, meaning all the guys who get involved in due diligences in some way. The second thing I'm looking at and this is the difficult part for me to show, but I think its there, is when there is a bit of a marketing approach to do these due diligences, research shows that the companies post mergers and acquisitions, are more successful. They've taken those marketing assets into consideration so that for me is the starting point of the integration. I don't know if you personally or [COMPANY NAME] are even involved in it to such a degree.

RESPONDENT 1 – Due diligence, yes, we often get involved in that. It's a regular feature of business in mergers and that sort of thing. Its interesting just in terms of ethical considerations but often we find that specific companies say SAB taking over Windhoek, SAB won't use their traditional trade mark attorneys, they would tend to go with the attorneys that are actually involved in the commercial agreements, so that is typically where we would come in. Some clients if you take SAB for example, their labour and commercial agreements and all that work are done here at [COMPANY NAME] but then their trademarks and patent work will be done by a different firm. When it comes to a mergers and acquisitions situation, then usually the company taking over would link our IT section with the commercial section **so they rather go for a**



coherent approach where we as novices to their portfolio become involved. I think there is a certain method in that madness and that is that if you are new to a business, I think you are more critical but if you've had attorneys for 30/40 years, you're not as critical or analytical as we would be as outsiders to the system.

CB - So, from your point of view what would you say is the current process you follow when doing due diligences involved in mergers and acquisitions. Is there a sort of structure involved?

RESPONDENT 1 - The usual approach is to basically look for the protection of the IP (patents, copyrights).

CB - You're approaching it from a legal point of view not from an accounting perspective or marketing perspective.

RESPONDENT 1 - We just deal with the legal aspects all relating to protection of the intellectual property.

CB - How do you do that?

RESPONDENT 1 - Basically what we do is we get information from them in terms of their major products, annual reports; information from the marketing sections etc. to make sure that the main products, the main money spinners are protected and no-one can come and steal the IP (patents, copyrights) once you've taken over the company. Sometimes we find that, with recent involvement with Nationale Pers, they found that Huisgenoot some of the trademarks weren't registered. It is not always inevitable for example that Afrox would have registered Afrox, sometimes people think it is so well known they don't think you have to register it. The starting point is therefore the major products, in terms of the names, trademarks. We then make sure that lesser known products need to be protected, and if it needs be that the trademark applications must be filed for them. Strangely enough, then we refer it back to the old trade-mark attorneys, so we lose out on some revenue there. That can be a massive process because trademarks are classified. On the trademark register there are 45 classes, example soft drinks would be class 32, clothing class 25. You get a variety of goods classes and service classes. Afrox for instance, you would get as much information on exactly what they do – their core business, services and products. Other important products that are within the market and then go through a check-list to make sure they are protected not only for the registration but also within in the right class.



CB –Let’s say you go to Afrox and find that one or two of their products are not registered but they are common known brands used in the market place. When that happens it’s obviously your advice that they secure that brand registration. If they don’t do that, is there anything stopping the previous operator of the brand continuing with that brand. This exact thing happened with BMW and Rolls Royce.

RESPONDENT 1 - One would govern that very closely in terms of the cut off date and also that anybody else related to the company or the MD can’t afterwards go and continue. So that is **one of the most important things to try and work out what you are taking over exactly.**

CB – Is your conversation when you’re getting into checking out these brands, trademarks, also related to services as well as products.

RESPONDENT 1 - What is usually spoken of, in general, which includes goods and services, we would talk about products, but technically either goods or services, both of them called trademarks, **we don’t talk about brands – we focus on trademarks.** You would differentiate between goods which are actually physical products and services and which are rendered.

CB - What sort of depths do you go to? Do you get involved with the clients?

RESPONDENT 1 - **You have to talk to them because sometimes you get a life cycle – then you must tell the client - listen, you’re not registered for popcorn – his response is for e.g. we don’t care anymore. Then sometimes there is something very new that has not been filed yet or sometimes the legal section and the marketing or production section are not all talking to each other so they can have a new thing but they haven’t registered it yet. So, from our side we have those communication problems in the middle of the whole thing.**

CB - How many deals have [COMPANY NAME] been involved in, in the past year in terms of due diligence.

RESPONDENT 1 - In terms of due diligence I can’t say – that would be difficult – on our website we have an amount for the deals we’ve done altogether. I know it was the highest amount in terms of South African firms. In terms of law firms.



CB - In all of those due diligences that were done, was your focus purely in terms of IP and making sure the trade marks are registered. There's nothing in terms of assets are in place and getting an audit of those, there's nothing in terms of culture or people or integration or any of those things. Your role is only on IP and registration of trade marks, brands, copyrights. Correct? Do you have a check list or process that you follow?

RESPONDENT 1 - We have something, but its not that we always work on it. I would say the easiest one to start with is the trade marks because it's like a visible thing. The more difficult one is patents and there one would typically also look at how far you are into the ranks of protection of the patent because it's only effective for 20 years. Close to 17/18 years then a patented article like Viagra has been in the market for 12 years so you've got 8 years left, how much will you be prepared to pay because you must realise that it's a thing that will disappear, whereas the trade mark runs for ever. In terms of copyright you've got lots of time, the death of the author plus 50 years so it's a very long period. This is the closest interface we've got to personnel and labour law section because in some cases you would find people design logos then the company would think they've got the copyright but then the copyright would be the property of an outside agent, like an ad agency, so it is important to understand that in some cases you would have to do an assignment agreement even at a late stage. If you say who designed the "Stoney" logo – they say it must have been marketing, but you can't find out - then someone discovers no, it was an outside design studio.

CB - In those circumstances, does copyright lie with that Studio or does it lie with the client who's procured that.

RESPONDENT 1 - It doesn't necessarily lie with the client. For specific types of situations like taking a photograph or painting a picture then its automatically with the person that has paid it, but otherwise the general rule is that the author will be the first owner, then there's an exception again for when you're in the employ of someone, if its in the scope of your duties then it belongs to the employer. In general if you're the author you become the first owner. You can have the situation where something has become valuable and then once the creator finds out its valuable, he would refuse to assign the copyright and technically he could stop the company using the logo. Then we would always check to make sure the important types of logos/designs that the copyright is in fact with the target company.



CB - If I ask somebody to design a Coca-Cola logo for me and then afterwards I sold Coca-Cola somewhere else, I'm selling the two together, it's a going concern and having paid that design studio would, in my mind think that I bought the copyright and the product automatically.

RESPONDENT 1 – If there is no conflict or aggressive situation, then there's no problem, potentially it is something that must be looked at. Patents must be registered otherwise there's nothing. Trademarks – the best protection is to register but it's not crucial for the protection of your rights - although the ultimate form is to have it registered. With copyright you don't have a registration system; it becomes effective as soon as you've created the work,

CB - and if it's original those tests are also there. When you talk about registration – obviously it will depend on the scope of your clients' activities, but it could just be South Africa, or world wide?

RESPONDENT 1 - it would depend on the space of the target - neighbouring countries could enter the picture

CB - Are those the three main things you would get involved in?

RESPONDENT 1 - practically it would be trademarks, copyright and patents are the main issues but then the know-how can also be massive – there you would have to have very tight employment contracts that you won't use it after you've resigned, restraints of trades etc. In the case of Coke people always say they've got no copyright or patent, its just this confidential information that nobody knows about - somewhere in Atlanta, so you have to put measures in place if someone would divulge that information later and obviously the higher up in the system you are the more restrictive the restraint of trade must be because the M.D. can cause a lot of damage

CB - In my practical experience, restraint of trade is worth very little unless you've paid the guy in some way – it's very difficult to limit their activities thereafter, because they adjust it slightly and say its not necessarily compatible and to cut the guy from an income source if that's all he knows. So these are the main key issues that you get involved with.

RESPONDENT 1 - There is a smaller one – designer rights – I won't say it's not important, but often it's not looked at. The designer rights would be for example the



shape of things – I would say it depends on the nature of your business, e.g. Jenna Clifford, it would be critical. Whole thing is shapes. Even thought about this T they use for rugby, so if you manufactured that you could register a design for the shape so depending on what you're involved in and also some of those companies at the harbours – those containers that are stacked, then you would also get a design protection for the shape say for pallets. So you would decide what is the nature of the business and then if its more consumer orientated then you have to be more careful with those products. When you move into financial services then you won't worry as much.

CB - When you said earlier on your website that [COMPANY NAME] had been awarded for the top due diligences, you're talking about these things.

RESPONDENT 1 - I wont say due diligences as such, its this stuff in the IP department.

CB - Are there other things you look at for example, agreements and contracts.

RESPONDENT 1 - Not really – we always interpret our task to be – is the price you are going to pay, is it worthwhile in terms of your IP rights or do you pay a price once you've got the company are they shaky etc. So all we do is to make sure that every aspect of your IP is protected.

CB - How do you link it to price? You just make sure the trade mark is there.

RESPONDENT 1 – Yes, It's not like a valuation we just make sure the trademark is there. The due diligence is purely to make sure that the thing you are buying, is it protected – in this country, certain areas.

CB - How long does this take? I suppose it depends on the size of the business.

RESPONDENT 1 - Sometimes you will find if you have a legal adviser who is quite clued up and has files and systems and sometimes there is nothing. So you could sit in the data room which can take weeks or months it depends on the complexity of the whole thing.

CB - In terms of pricing how is this done? Is it done on a time basis or on the value?



RESPONDENT 1 - It differs, most of the time the commercial guys would give a quote e.g. R10million and then we would be allocated a certain portion. They would draft the M&A agreement and part of it would be the IP.

CB – Then that would be Commercial here, [COMPANY NAME].

RESPONDENT 1 - Yes

CB - So that's the other level you're involved in – actual Agreements of sale or heads of agreement.

RESPONDENT 1 - Commercial guys would draft that. Only for the drafting of the IP clauses would we be involved.

CB - The commercial guys would they do any other due diligence exercisers to discover the position at the target?

RESPONDENT 1 – No, they would look at the agreements and negotiations - they would look at Reserve Bank approval and competition board negotiations, maybe even labour union negotiations.

CB – It's difficult for me to go through all these questions because I've realised that they're not relevant to you, there's nothing here involving brand equity or marketing audits or anything in terms of other intangible assets, some of them we've spoken of already.

RESPONDENT 1 – Our job is very technical, there's nothing soft. You could say it's a legal audit.

CB - Once a merger and acquisition has gone through obviously it depends on the level of the company, public or on the stock exchange, there is certain reporting that must be done after the fact are you aware of what that might be from a legal point of view.

RESPONDENT 1 - Only the corporate guys can help. I can think of one but that will be in terms of the companies act not IP.



CB – I think that's it for me. I understand that's what you do and there's nothing more for me. Yes there's time but its nothing more than a legal audit that you do more than anything else. In terms of this legal audit that you do what is the percentage of the deal cost.

RESPONDENT 1 - I think e.g. if the deal if R100 million, then legal costs might be 5% of it and then our cut would be even less. If the transaction was bigger, it doesn't necessarily mean the costs would be more as there are only certain things that you do.

CB – To confirm - A Brand to you would be either trademark or copyright.

RESPONDENT 1 – When we talk about Brand – we usually think in terms of a trademark registered on unregistered, but the protection is just better when it is registered. We don't go into the brand image, or the PR side of it. We would venture into it very cautiously because that not our business.

CB - Thank you.

.We exchange contact details and end cordially with option to call in future if necessary



APPENDIX K2. RESEARCH INTERVIEW – RESPONDENT 2.

CB – Introductions and general discussions.

If you don't mind, just to put things into perspective, could you maybe just tell me where you fit into mergers and acquisitions and what your role is and maybe even a little bit more about what [COMPANY NAME] role is.

RESPONDENT 2 - Obviously, personally I fit into the tax side of the M & A transactions and from my perspective maybe it's a bit biased but I think the tax division is very often the engineroom of any transaction. We basically say well does it work from a tax perspective, lets assume the filing costs become prohibitive, its inefficient, then the deal doesn't go through. Sometimes I ask clients, before an assignment starts do you want to look at the rough structure side first or do you want to do a due diligence revue first, because if it doesn't fit in structurally and you can't fund it appropriately, and there are too many tax leakages from the re-structuring, then you don't need to bother about the DDR. Clearly, why would you go into detail in the structuring side if the transaction doesn't seem to be possible from a DDR perspective, because of too many risks.

CB - What do you think – are you suggesting that the motivations for mergers and acquisitions are not always to gain more market share or to gain better customers and there are over-motivations which are obviously at some times primarily financial.

RESPONDENT 2 - Look, you've got different clients, we are looking also at different clients, some of them are the strategic buyers who basically want to expand their business in a sense of adding a service line and then you've got the private equity transactions and they simply say well I have a lot of money available from my investors and where do I invest it best. So, they obviously have their own industry from which they specialise, but they can be all stand alone transactions and acquisitions.

CB - Are you, in terms of the kinds of transactions that you're doing, I suppose BEE would be another motivator really, but are you finding that the majority of them are more investor driven and BEE kind of companies, private equity companies.

RESPONDENT 2 - It varies, obviously merger and acquisition doesn't give you the full description because it also includes disposals of non-core assets but the last couple of ones I'm currently involved in the major disposal, unbundling, I've been involved in the unbundling of PPC by Barloworld and that's really what drives a transaction and in this particular case it's shareholder activism or share holder pressure and so you've got to



do something and that means focus on what you really are best at and get rid of non-core assets, unlock value for shareholders. So I think there are transactions driven by what is hopefully what is best for shareholders as apposed to what is best for management and this for shareholders very often you'd want to unblock the discount and the holding company. PPC as my example has been running successfully, for decades as a listed vehicle and the question was whether Barloworld didn't impair the marketability of the share/float. Having held 72% that means free float was reasonably limited and I think it was actually received quite well by the market when the unbundling was announced. So as I said, that's really on the disposal side and we've been involved in a lot of disposals where Anglo for example wants to get out of non-core assets and we are basically helping them from that perspective. If I start on the other side, one of the aspects which has become far more popular in the recent past is vendor due diligence revues because I think people are trying to have a bit more tension in the disposal process by basically inviting various interested parties to tender for the acquisition and instead of having 10 000 teams running through your offices, the vendor says I'm going to do a due diligence revue on myself, I'll prepare a report on myself, obviously with the assistance of my advisors and I'll make that report available to purchasers together with my information memorandum. Then the whole elimination process starts – we've been involved on both sides, the buyer and the sellers side. The transactions where there are a number of bidders, through the elimination process, sometimes you start off with 12 – 14 bidders and they ask to give a non-binding initial bid and if people don't like it, and certain other information, they get eliminated in the first round – obviously one tries to keep the rounds as few as possible, but I certainly have been around some transactions where I think there were 3 – 4 rounds. Every round the people get more detailed information, more access to more sensitive information and clearly you've got the black box where you, the final bidder, gets access to. So, that's really on the selling side where we do a lot of work and obviously similar to what we do on the buying side. We also do due diligence revues but structuring is absolutely critical but also the actual implementation and we spend a lot of time implementing the transactions.

CB - This is more in terms of the finance though; it's not operations or any consulting element?

RESPONDENT 2 - What we're trying to do is give clients an implementation check list and I have always emphasized very strongly to clients, that there is no such thing as a perfect implementation check list and we try to cover as broad an area as possible not



because we know everything, but once you've done a couple of transactions, you know where more or less the problems are and they start with the implementation of the agreement which is not a given because the deal is not done when the agreement is signed, that only where it starts, and the taxes aspects, the logo aspects and they're simple things – if you want to unbundle a company that's always been a division of a listed vehicle, who's going to be your board, your non-executive director, have you got a domain name, possibly fitting into the branding side, simple things, the list is endless.

CB - Obviously for each company it's going to vary, wherever their emphasis is.

RESPONDENT 2 - It is obviously also very critical if you buy – how do you allocate the price – If you want to have something in the agreement which hopefully is in line with what the auditors finally sign off on.

CB - This check list, is it something that you can share with me. I don't know if its too generic?

RESPONDENT 2 – look, as I said, there is no such thing as a perfect list, its also a living document, I'm not so sure if I've got something which I can easily give you because what we sometimes also have is a sort of broad framework per step what has got to be done and then you draw on, say for e.g. you have got a sale agreement has to be signed if you're selling the better part of your business, have you got a section 228 resolution, if you take advantage of the corporate relief provisions, make sure that you trace the base costs properly, if you need to get the transfer of the shares make sure you've got an affidavit. Its like opening a bank account – you think it simply carries on if you start trading under a new name – advising your suppliers that your bank number has changed – your name has changed – registered – deregistered and so forth.

CB - Your relationship with your client – how is that initiated – does it come through from the auditing side in terms of your business or is there a conflict of interest there, or is there not a conflict and that's where the interest needs to lie based on your auditing background. Is there any sort of cross feeding between those or any ethical considerations in terms of how you deal with those clients?

RESPONDENT 2 - In the ideal world we would like to do all the M&A advice on all our clients – there are always the questions of independence because at the end of the day the auditors are signing off on basically their colleagues have advised on, so there is a



perceived independence - certainly from the SEC perspective advising on M & A transactions is a permitted activity. Even if we are the auditors, we can get involved in the M & A activity but with certain limitations e.g. we can never do the legal work, we can never do anything which involves valuations, we can never take decisions – we can advise but we cannot take the decisions.

CB - The implementations that you're talking about now, are they relative all the time or only when [COMPANY NAME] is involved with the audit.

RESPONDENT 2 - The SEC (Securities Exchange Commission) restrictions apply when you are the auditor. in the US – so if you're a listed entity in the US you're subject to the SEC restrictions - that means if you're an auditor, you cannot advise on certain matters and there are lists as to what you cannot do. You may not be the auditor of the company involved but you may be the auditor of the holding company, assuming that this is a substantial subsidiary. There are limitations and with the introductions of the SEC restrictions, a lot of other countries have followed suit where essentially they are actually trying to split the audit role from the consulting role and even where it hasn't been legislated, companies believe that it may well be better practice to split the two – depends obviously who you talk to - clearly we as auditors would always say we are in a far better position to advise the clients properly simply because we understand the business much better. We have a far better background and can advise more accurately on specific issues.

CB - Obviously it's up to these regulators to decide.

RESPONDENT 2 - If it's a self imposed rule it may say, and that applies to the SEC regulations as well, we can do consulting work but with pre-approval from the Audit committee and they sometimes have different levels of authority.

CB - Audit committee within that business – within that company. In terms of account process followed during Mergers & Acquisitions by the top corporate financing advisers, how would you summarise that process. The process followed around Mergers & Acquisitions, although you say its different, depending on the motivation, whether its private equity, growth, BEE, so I suppose – you did mention initially, the most important step, at least for you, is to look at the structuring and the tax before the deal gets put through and there in terms of structuring, I assume you're looking at how are things going to be funded, what elements are going to be equity, what's going to be financed from which sources, at what rates, and things like that to see whether it stacks



and sort of makes money for itself - from your perspective that's really the beginning of the process.

RESPONDENT 2 - The beginning is possibly a bit earlier, presumably the private equity fund has done some homework on targets which fit into their industries, because they're also not just buying everything. Private equity funds have generally speaking clear criteria and normally, because it's a highly geared acquisition it needs cash flows, so it's absolutely critical that's why the retailers have been so popular because lots of their sales are cash based. So they then basically target an entity and I think we've been advised by one of the private equity funds that they look at ten and maybe one goes through, so they look at it very broadly and then very often after an initial investigation and examination they find that it's most probably not going to work.

CB - One of the things you mentioned earlier on is that you are not involved in valuations.

RESPONDENT 2 - Not me personally – [COMPANY NAME] will be but not on Audit clients but we do valuations for non-audit clients.

CB - So you are able to see if there is or isn't value in the deal whether you've done the valuation or not just in terms of the process, the methodology and the cash flows coming out of it.

RESPONDENT 2 - We do sometimes do sensitivity studies – we do a lot of simulation based work and that sometimes fits into what the clients are doing, we simply say, for e.g. we did a transaction - if we pay R20 what is it that we create. If it's R21 what's the acquisition price, what's the tax leakage, ours is more driven by tax leakage but obviously it also may give you a hurdle as to where you cannot create more tax benefit - let's say for example because of its income capitalisation rules – so now you say I've got to bring in more equity and we do that at different prices. Tax leakage models, clearly the client will feed it into what their models are and see to what level can they basically bear the brunt. You may have seen the articles about the Edcon acquisition I think Edcon's profit the year before was about R2billion, they bought a place for about R26billion now in the ideal world I think a private equity fund would have liked to have at least 20% - a maximum of 20% equity. That means R20billion debt and R2billion bottom line, it's getting tight and when you look at the funding there's obviously different levels of funding, the one is highly secured and then the high yield bond which ranks virtually just before your shares rank they come easily at prime plus 4. The only



constraining factor is basically Reserve Bank if you want to have foreign funding and you may have seen also on the Edcon transaction that the Banks provide almost a bridging finance and then they try to auction off the paper. They apparently now got burnt so badly because the bridging funding is not a profit scheme for them

CB - but they look for arbitrage opportunities?

RESPONDENT 2 - but also its more to get other work, maybe they lend money to the business themselves and then simply have the bridging loan to accommodate the client to basically get the assignment. In the Edcon deal the articles said that the interest rates globally have moved and they are battling to get rid of that paper and its not only on the Edcon fund its private equity funds too.

CB - The more we're talking, the more I realise I should also be talking to the private equity players in terms of this thesis because they may consider brand at different levels just in terms of the business that they are buying but they do it indirectly in terms of the cash flows that it spins out and the access to clients – I may need to include them in this conversation/thesis to find their motivations to find what they look for in terms of structures and things like that. From your perspective you don't necessarily give any consideration to the new entity if there is going to be a new one, or the brand or the marketing relating to that at all, does any other party do that within [COMPANY NAME] or is the role purely financial.

RESPONDENT 2 - It's financial or tax, there's no consulting before the case in terms of drawing in HR and culture issues and drawing marketing brand customer issues in.

CB - Doing a marketing audit in terms of who the customers are, how they may be different from the target or the acquiring company, how these things are going to sit together, that clearly is the responsibility of the people that are buying into each other, but the sooner they do that, the better for them than after the fact, when they may find there is no match or synergy. Does [COMPANY NAME] play a role in that kind of process.

RESPONDENT 2 - It seems to me to be two issues, one is possibly the harder part to it and the other the softer part to it, certainly from a corporate finance perspective I think that part of their financial due diligence revue they would be looking at supplier base and customer base so its quality of the customer. What you would also be looking at is whether there are any conflicts. Like now, we have been involved in a transaction where we were considering the disposal of a business but we had a joint venture with a



particular global player and if we were to sell the business to a competitor, then the joint venture would fall away. So you are definitely going to look at your customers and your suppliers from a legal perspective, from a corporate finance perspective. It has very often less impact from a tax perspective. So that's what I would call the harder part of your question, the other one is really the cultural issue. We obviously, through our consulting division human capital, they do a lot of work around culture. I think its most probably a hugely under rated aspect of a transaction and you will find that very often suddenly news of a potential disposal leaks then basically the good people jump ship and you're left with rubbish, so that aspect has to be handled much better in practice than it has been. Its normally a funding driven issue, a tax driven issue and you think you're going to create value and that is most probably why they keep on saying two-thirds of global M&A transactions are unsuccessful, not the right cultural fit. Obviously the two competing CEO's both think they should be the CEO's and its falling apart – try and sell that to any client - the HR or human side, human resource side is critical. Then also quite important, I think you need to understand if you've been operating successfully as a subsidiary of a listed company and now you're let free, is the M.D of a subsidiary or a division a good M.D or CEO of a listed vehicle. Is the FD of a division a good FD for a listed vehicle? Very difference requirements and I think very often people believe its just business as usual, its not, -

CB - there are certain governance issues that were part of the group before, all the committees whoever they might be that are not necessarily entrenched to the same degree in that subsidiary or division?

RESPONDENT 2 - Who do you make Chairman, MD or CEO, who is the FD going to be and I don't think, generally speaking that the personalities involved allow external parties to say lets look at what is available and lets assess the qualities of the people because they may not be there anymore. It's a huge conflict of interest.

CB - Private equity firms would probably have that kind of thing taped – I'm guessing. They stick their money in and they want it to grow as quickly as they possible can, they want to exit in a time and surely that's there motivation.

RESPONDENT 2 - Private equity firms don't normally want to run the business so, they look at management, if there are no good managers they probably won't even touch it, or they generally have people lined up in the background but that very often goes hand in hand with a hostile takeover and they don't work very well. I know one of the big private equity funds in town has a policy 'no hostile takeovers' whereas another



one is not scared. I've seen two attempted hostile takeovers and neither of the two worked.

CB - it's the same culture issue. The [COMPANY NAME] human capital division are they often, closely enough, involved in deals like this or is it only as and when they might be called in at that time, or are they always involved after a deal.

RESPONDENT 2 - No, they are not always in – I think in an ideal world if we were of offer a comprehensive M&A service, they should be part of it, but it's one thing saying to the client it is what you need but another thing client agreeing to that they need, and how much they need. Unfortunately its bits and pieces, they fiddle a bit here and the client says don't worry, I've got it covered and then there's another hole and they don't realise the magnitude of the whole thing when they get started. Corporate finance, legal and tax we find, assuming there are no limitations, valuation, in terms of auditory rules, very often a private equity funder has their own corporate finance people.

CB - From a brand value point of view, if you are involved in it, how do you value brand within the transaction.

RESPONDENT 2 - First of all, I personally never get involved in the valuation but I would say its possibly the royalty method.

CB - I suppose it depends on what you do and there are different practitioners you talk to. If you talk to a guy like [NAME] from a business called [COMPANY NAME], he understands exactly what that royalty method is, how it works, but to him there are fundamental flaws in it. If you talk to another party like [COMPAY NAME] in the UK or [NAME], they would focus more on the [OTHER] methods, so between them and often surprisingly they come out with similar numbers but their approach academically, or strictly in terms of which method and what has the best value, differ slightly.

RESPONDENT 2 – If you're a good bunch, as a marketing adviser, you give the client a document evaluating different methods just off the shelf and I've seen them conclude, very often on the royalty one being the most favoured one – its just a question of what rate of royalty you should be using. Then you say, what's the intention of the party, I need a big trade mark write off which is no longer possible so, **if you don't like 2% I'll make it 3%. How do you choose a royalty rate, you can't benchmark it?**



CB - especially if you are the owner or the brand. From your perspective, is there ever something like a marketing audit done before the mergers & acquisitions process. Not in terms of Deloitte, in terms of your structures.

RESPONDENT 2 - I'm not aware of any marketing audit having been done – we do a lot of legal stuff, tax stuff, financial and I think the environmental part becomes far more important going forward than it has been in the past, but I'm not aware of any marketing audit having been done by qualified people.

CB - Just in terms of [COMPANY NAME], or generally in terms of the industry.

RESPONDENT 2 - Generally.

CB - How do intangible assets affect you and how do they affect the transaction, how are they valued in terms of the deal. Just to put one or two things in perspective, in terms of the S&P 500 companies in the States, they suggest that of those companies, if you had to aggregate their balance sheets, 60% to 70% of the value of those balance sheets would be intangible assets, would not be the tangibles, which, and I don't know if that trend is equally relevant in South Africa, I think it would be for some sectors, for some which are more resourced based, it might be different. How do those kind of things factor into the decision. I'm sure they would have their own consideration in terms of tax, as you said trade mark write offs, where they are/aren't applicable and things like that, but in general terms what's your view.

RESPONDENT 2 - You would value the business as a whole first of all – is it a profitable business, does it generate the cash flows, will it be able to pay off the purchase price then I think its only a secondary question as to where it (intangibles) fits in. You've always got to be mindful of what the accountants think or the F.D. because you want to report headline earnings – from a tax perspective, yes if you've got plant and you sell it as a business as a going concern you don't have corporate relief provisions, very often you've got massive recoupments that means tax at 29%. If you can contribute it to say goodwill, goodwill doesn't have any costs of a capital nature so you just need to look at the base.

CB - It is of a capital nature?

RESPONDENT 2 - It is of a capital nature and that would attract capital gains tax at 14½%, so looking purely at the tax arbitrage I would try to attribute as little as possible



to plant and more to goodwill. That's assuming you bought it and contributed an awful lot of value to the plant, guess what your headline earnings show – depreciation. If I've got goodwill I only impair it if there is a reason to impair. So my headline earnings look an awful lot better if I attribute the purchase price to goodwill than to plant.

CB - So in both those scenarios never mind the level of tax you pay but as well as the headline earnings rate you report, its more beneficial for you, I wouldn't say manipulate, but in terms of the selling price to reduce it more to goodwill.

RESPONDENT 2 - Obviously the accounting side has become less flexible than in the past, they simply say you have a fair value in the asset. In the perfect world there is no goodwill, its all attributable to contracts, copyrights patents etc. Just an example what I've seen also you've got say a company called A and it has trade marks 1,2,3,4,5,6, the question mark is what should you be attributing value to – is A really the overriding one and should anything be allocated to these ones at the bottom and I've seen where the client argued quite vigorously that the 1,2,3,4,5 trade marks are all irrelevant if it is the overall name 'cause if I go to a shop I want the fruit juice from A, they don't say I want one of those specific names for it.

CB – That links to this and links to that – there's the central element and all those other tie in around here – it's that part there where the brand equity, or the value lies

RESPONDENT 2 - These are established product names in their own right, so I'm not convinced that you can disregard all these saying they have no value because a lot of people know them they are the products they use.

CB - That's where something like a marketing due diligence will come in, in terms of the clients how are they segmented, what the risk of them is, demographic of those clients, what the brand royalty of those groups are, how they are/aren't aware of the names and brands and you can measure those things – that's how something like that would factor into it, quite interestingly actually.

CB - What would you determine as a measure for success in terms of mergers and acquisitions, you said earlier on 2/3 fail whether its culture, bad planning, bad structuring – but those that do succeed what would you determine as a measure for success.



RESPONDENT 2 - I come out of the tax side so what's success in my books is not necessarily success in someone else's books. You always need to see why do people acquire it so if you look at a private equity fund, it wants to make money and we all do. Private equity gets in, gears it heavily with everybody else's money and 5 – 7 years down the track they want to sell the business for profit. Obviously you need to make sure that its streamlined, there's no pressure as half yearly or quarterly reporting so they can just run the business and make sure they make money in the 5 – 7 year period, so I think the equity funder is just in it to make money. Possibly strategic buyers may have a different objective and say synergies – the most used word in M&A transactions, cost savings – you look at the motor manufacturers if they can share their chassis with various models, its one part R&D for 10 cars, so I would think it is most probably successful if you achieve your original objectives. Obviously, objectives these days can no longer be measured purely in financial terms like understand this concept of triple bottom line that may come in as well, environmentally friendly, social responsibilities towards your employees and everyone else.

CB – I think I have enough from you, some of these issues here are more marketing related or brand related and as you said you'd prefer to avoid that for now. The one thing I would like to ask you is, maybe this is more a matter or stats or access to information and that is in terms of due diligence itself I know that it may change based on these objectives and motivations – how many of those deals has [COMPANY NAME] been involved in from a due diligence perspective, over the last couple of years – do you keep that information. Does that all go back to the client once the deal is done, what's the process.

RESPONDENT 2 - We have our own copies. Lets take some examples – I never keep track, whereas one of my colleagues can prepare her CV and mention every client she's ever work on in it. You basically get deals which go through or not. What you find from time to time is if the deal doesn't go through you are obliged to destroy or return all documentation you've ever laid your hands on, including electronic stuff. Obviously it's a bit tricky if at the very least if it does go through - we can't destroy records following Anderson, records are not quite the thing we do but we would like to keep them for our own protection, e.g. this is what you've given us, this is what we've advised on, this was our advice –

CB - in a confidential nature and secured?



RESPONDENT 2 – Yes, we keep confidential folders separate folders, separate access - only people who have signed the confidential agreement will have access to it. For virtually every DDR I've done – it's somewhere in the system.

CB – Thank you for your time. Do you mind if I call you if there is any other information I need.....Was this useful at all to you in any way –

RESPONDENT 2 - I've never thought about marketing or brand DDR but I certainly see that there could be scope for it and certainly the brand destruction – you look at Daimler Chrysler and you know that they collapsed.

CB – There was a very interesting case study that I read on the Daimler Chrysler deal and I think it was the F.D from the Daimler side said everything was going great until they started talking about the name – there is another interesting story of a similar nature also in the motor industry - a while ago the VW group bought Rolls Royce from BMW, but they found through the transaction, whether it was deliberate or not, they didn't actually buy the brand, the name, they bought the rest of the business and they eventually turned it to their advantage and used that platform and technology and structure of people to drive Bentley sales. VW and Bentley were all part of the same thing at some stage, but they didn't get the Rolls Royce brand. In that kind of example these things become very critical and somebody dropped the ball there – it might have been in terms of contracts, trademarks. I think that the majority of the things we do these days are very strongly brand related – if you look at the entire franchise market – if I buy a franchise I might be selling chicken – I bought a franchise because I'm linking to the brand and what that stands for .

RESPONDENT 2 - The anti competitive problems associated with franchises which really is undermining really the value of the brand. An interesting one from the service industry – have you ever heard about PWC – who's it –

CB - Price Waterhouse Coopers

RESPONDENT 2 – The name is not PWC but everyone calls them that. There is Deloitte & Touche, when people talk colloquially, they talk of Deloitte's "nogal", with the S - not Deloitte, E&Y – people don't say Ernst & Young.

General discussion on some interesting brands - conversation ends.



APPENDIX K3. RESEARCH INTERVIEW – RESPONDENT 3.

CB – General introduction on topic thesis and process of interview.

RESPONDENT 3 - I agree with you 100% and what we're seeing is when guys make the investment the cash flows that that brand generates that's what is important when going into any merger and acquisition activity. In terms of the valuation sometime the price paid is a lot more than maybe intangible assets and I suppose your question is, at the due diligence phase to what extent are companies actually focusing on attributing the value between the different components other than the tangible assets. I can tell you from our experience, it generally is an afterthought. So what is important when we're advising the client and how they're pricing it, its more around do they have a brand, are they going to pay more than the tangible assets, what is that goodwill element, do they see value in that and the value is all around the cash flows that it generates. What tends to happen as an afterthought is the accounting statements say you must now split what that goodwill number is and it tends to be done post transaction. Just as a compliance measure as apposed to saying upfront is that our brand. I would certainly say as well, in terms of any M&A activity, what's important when you buy a brand is for them, and I'm sure they think about it, what is the consequence of buying that in relation to their own business. So where you have competitors they might have similar kinds of products in the same market space, do they now put it under the same brand, which then would put the brand that they're buying actually it would be worthless. What they more concerned about is what cash flow is going to be generated from that acquisition. So I would certainly agree with the other guys where they say putting it into the box is really done as an afterthought in terms of compliance. Certainly a lot of thought would go into a transaction rationale - why we're buying it.

CB – In terms of guiding their thinking, is that something that [COMPANY NAME] does as part of the due diligence or beforehand in terms of considering those elements of brand, because the only reason there's a link there is because of the cash flows. Brand from a marketing perspective, and I suppose you have different views, is the link to the customer, that's the thing that he identifies with, maybe some more resource rich kinds of businesses doesn't matter what it is but in others where there are products or some sort of client relationship, all those things are linked to brand, loyalty, awareness, buyer behaviour and maybe even a premium in terms of what's been paid for that product which might be some of the initial synergy sort in the merger. Is there a role that you play in terms of directing the client? Obviously those issues are going to face the client



or the buyer at target and they are going to have to deal with it in their own way internally. Because they're dealing with it, is there a role that you at [COMPANY NAME] facilitate that discussion, or consider integration of these brands, or different clients that may be coming together, different products in the delivery between the two. Is that something that you do or is it more clinical - like that's the scope for my due diligence I want you to confirm this, I've paid for that – go –

RESPONDENT 3 - I don't think its as black and white as that and certainly in terms of the brand, it mainly goes around market differentiation and being able to pass your product maybe in a basket of goods differently to your competitors. Its exactly what you're saying, customer loyalty and all of those things and within any transaction **the most important thing for the acquirer is to understand exactly, they're buying this business, how are they going to integrate it. They would often have their own understanding, what the synergies are, what the integration plan is, but that generally would happen post transaction. Some of the services we offer do deal with those but in the context of the due diligence it's more around confirming the robustness of the financial information. Understanding those cash flows and the ability for those cash flows to remain like that, sound.** The assumption is looking forward based on the historic information and we don't really go into the synergies and taking that into account. To us, we see that more as the buyer bringing that value to the transaction, as apposed to the buyer paying the seller for the synergies that they're going to create.

CB - So the cash flows that you look at are in terms of the seller's financial report, you don't look at the two coming together.

RESPONDENT 3 - 100%.

CB - Stand alone entity, you look at the seller's forecast?

RESPONDENT 3 - **We look at the business that's being purchased what the cash flows are around that, we'll identify the risks in those cash flows and at the same time part of the due diligence is enlightening management who are buying the asset on what brands exist, what value sits there, what revenue streams are accounted for, what customer base looks like and it would really be up to themselves to say is there a possibility to leverage their current customer base into that.** All those integration issues generally seem to be done post transaction. It doesn't mean that the buyer doesn't think about that. I think an important thing to note on the synergies is that depending on how they're buying the asset, if it's an exclusive deal they will decide the maximum



amount they're prepared to pay, when you get to an auction situation, buyers tend to say they're going to put in a bid that that's the maximum they prepared to pay. Sometimes that would include synergies – they say here's a group – the cash flow generation, you get rid of all this duplication, that certainly will create synergy.

CB - cost benefits?

RESPONDENT 3 – Yes, and its more functional they don't want to lose the asset when you're putting a lot of money into the sales process. A lot of the private equity deals on an auction basis generally they do pass some element of synergy into their price, because no one knows what the other teams are putting in for the asset and you don't want to put in a price that too low but at the same time something that's too high for the value out there. It's a bit of a fine line.

CB - Do you get involved in valuation of these assets? If its more tangible stuff there might be book values of what these things might be – I know I'm talking generic, but there are so many different transactions out there. What do you do when it comes to the intangible stuff? How do you, if you do, report a value on that?

RESPONDENT 3 - On the due diligence side we don't report on what the intangibles are and put a value on that, generally that gets done post transaction when we differentiate in terms of the statements, the compliance of what value will be attributed to the different parts. In terms of valuation the client generally would come up with their investment case, how they valued it, the due diligence will confirm a lot of those assumptions based on historic performance. If they wanted a valuation to be done, if they haven't done it themselves, that's where [NAME] and his team would generally be involved. Up front, were not involved in splitting it into the different intangibles, we just assume its goodwill. It really seems to be an afterthought.

CB - When it comes to the accounting, then numbers are allocated in whatever way so there's compliance?

RESPONDENT 3 - Generally, buyers are saying that's an accounting issue, it's not a value issue. We've seen the cash flows that are being generated and we believe those cash flows, that's our discount rate, that's how we pass it.

CB - So your assumption is, and its quite a safe assumption, is that the cash flows are a function of brand, assets, intangibles, management, all those issues that are in the



business, you test the cash flows and if those are right, the rest you account for in whatever way?

RESPONDENT 3 – 100%. All of those brands are intangibles - plus the assets are needed to create those cash flows and that's generally what the buyer's interested in.

CB - Do you have a general process that you follow in terms of doing due diligences?

RESPONDENT 3 - We have a global methodology – whether we do a due diligence here or overseas, we do follow that methodology. I think the most important thing is the scoping up front with the client, what the client wants to understand about that business. The areas of focus are quite different between the trade buyers and private equity buyer.

CB - By trade you mean someone in that industry?

RESPONDENT 3 – Yes, whereas a private equity buyers will be looking at the ability for the business to put more debt on the balance sheet, the ability to leverage up to meet those commitments going forward. Generally the private equity guys don't know the market landscape, the competitive behaviour of the business so if we're doing something for a private equity player that comes from a position of less knowledge, we would maybe do a fuller scope due diligence as opposed to a trade buyer who would be focused on certain specific elements. We don't operate on check lists, although we do have check lists just to remind ourselves what is it we should be doing, it's really agreed with the client what is of interest to them. Generally, what is of interest to them is to confirm the basis on which they value this business. To gain an understanding of the risks or the downside, as well as the potential upside going to the synergies that this acquisition will give to them. From their side they don't want dilution.

CB - How do you do that if you don't put a focus to any way on the synergies. If yours is only on what's being purchased and it doesn't incorporate the new value that might be coming to this business through these synergies. How do you assess that?

RESPONDENT 3 – It goes back to the point if I'm buying as asset any synergies that I bin or ideas that I have to reduce costs under my management as opposed to that management, that's value I bring to the table. So the due diligence tends to just focus on the asset that you're buying. To really understand that asset, the business drivers, the revenue drivers, and again confirming the reasonableness of the assumptions



really around the cash flows which in essence is what drives the value you are prepared to pay for it.

CB - Do you also as part of your due diligence test anything that relates to that market in terms of market share, in terms of customer demographics, in terms of loyalty to products or brands? That's quite a heavy, quantitative research kind of thing which needs to be done – contacting customers, some sort of marketing research, is there any element of that which exists?

RESPONDENT 3 - If you look at the due diligence there are a lot of definitions for it and a lot of different pieces of work that can be done. We tend to focus on the financial elements, tax elements and attend to the system elements. We do get involved in tax structuring for client that's called commercial and operational due diligence. We generally would say you should get those experts to do it, we don't carry legal experts. The legal due diligence would be done by those professionals.

CB - A lot of the legal terms are getting into M&A on quite a big scale.

RESPONDENT 3 - Certainly we're seeing the legal firms competing very strongly on the tax area, and tax structuring, they're not going so much on the financial due diligences and they are definitely guys to be reckoned with, they are all building capacity in those areas and I suppose it just links to that transaction and really combines well with their product offering. From operational, commercial due diligence reviews generally you'd find clients would either do it themselves, they know their industry, they play in that space, or they would go and get experts like [COMPANY NAME] OR [COMPANY NAME]. It doesn't mean that as part of our process we won't identify certain issues around that, but the in-depth analysis, we wouldn't do that.

CB - Do you also play a role after the fact, post the merger.

RESPONDENT 3 – Yes. We've got a product that we call the [PRODUCT NAME] - its almost like your check list saying once you've made an asset purchase what has to be done in that first 100 days which is the most crucial period/area, where you need to integrate. If you don't get the first 100 days right, the chances are that that merger or acquisition is not going to be successful. So we do offer some services that look at that 100 day plan and a lot of it is driven off the findings of the due diligence.



CB - Which becomes the agenda?

RESPONDENT 3 - Exactly. The findings of your due diligence will either funnel themselves into this 100 day plan or what needs to be in the sale or purchase agreements and the terms sheets. The 100 day plan is really executing on either those areas of risk or identifying areas that need to be focused on and what work must be done around that. So we do some post deal integration work, not as much as probably we should be, because generally what the clients like to do is they like to put their own management team in there because those are the guys that will have the responsibility going forward and then let them drive it out of the output that we have presented.

CB – They'd use the same sort of output.

RESPONDENT 3 - 100% and it wouldn't only be the due diligence findings from our side it would be the legal side.

CB – Tax issues, structuring issues would also come into it.

CB - You said you don't really look at intangibles?

RESPONDENT 3 - But that said, an important part of due diligence would be to understand what intangibles there are, for example - a technology company and they have developed a system, what would be important would be the rights behind that system, did they contract people up – who can then support it if that guy get run over by a bus. That goes around the whole purpose of the due diligence, what is the risk behind that proprietary technology.

CB – Do you quantify that risk or do you identify it.

RESPONDENT 3 - Its either a risk or its not and we would really look at the documentation in that example that supports how this piece of software was developed. The other thing might be on the mining side if one business has a relationship for example with the community that the community owns the prospecting license, and they do it with the community the whole thing would then be about who is then responsible for rehabilitation, what are those payments to the community, who monitors the increases it all links back to the cash flows because if one of those things were to fall short, your cash flows would be impacted. So that's really the focus of our



work – what is going to affect these cash flows, and what is the risk that any of these events may happen. That would make you pay something that may not materialise.

CB – Because the valuation is based on that?

CB – Obviously in each deal its going to be subject to your interpretation and your client's scope

RESPONDENT 3 - I think what's very important is that you realise, and that's our philosophy, that due diligence is not a structured process like an audit although there is guidance and there are templates, but really leads to discussion with the client. At the end of the day it's about knowing the industry, understanding the rationale and where management see the value of this transaction. What they believe are the reasons they're making this deal and why they are prepared to pay the price and we would focus on anything that would really be contrary to what they believe in. Or if they believe that this is going to happen but there's a risk that it might not happen, that is what we would focus on. So, other than just confirming the numbers, which obviously are very important, it's also about the risks. You have to understand the industry, you have to understand the rationale.

CB - It doesn't have to be numbers or tax, there could be plenty of reasons.

RESPONDENT 3 - The due diligence process is not as simplistic as – have you done this or that, it's a lot of interaction with management, depending on what you see, read and your analysis tells you, it then will send you to an area where you would either highlight a risk or not. We go a step further where we say to the clients, which goes back to the 100 day plan, you've got this risk, you've got this issue, how do you deal with it. Is it a warranty, is it something you need to get done in terms of systems, make sure you get that done and be aware that there's a cost attached to that which again has a valuation attached.

CB – Most of the other players in this environment, just from a pricing point of view, normally price a due diligence to a customer based on time, do you follow a similar system?

RESPONDENT 3 - Exactly the same. To expand on that a bit the reason it is time based is we can't take the success based fee in terms of conflict and independence, if you say pay me 20% upside if you do the deal the perceived concept is we'll only tell you good things. We are on neutral ground, we're advisers and we need to tell it the



upside as well as the downside. We don't only focus on the risks, we also say these are the positives and it's really about helping the client be better informed when they go into a transaction. So knowing that they feeling comfortable and getting what they're paying for, that they price it correctly, to the extent the risks are there, that they've actually guarded themselves against those. As I said, we go a step further to say this is how you could make it better post transaction.

CB - Besides that perceived risk that you could indirectly be incentivised to get the deal going if you're paid on risk, what other restrictions are there around, particularly if you're involved in the business in audit or tax. Any restrictions applicable in terms of due diligence. Maybe you're the auditor for company A who's looking to be bought by B, B's the guy that hires you.

RESPONDENT 3 - We have global policies on this – I think simplistically **we're not prohibited from doing a due diligence for a channel one client, being an audit client**. We can do that in certain circumstances, e.g. we audit the target now we must come due the due diligence. Straight away the perceived conflict is at [COMPANY NAME] the advisers identify something that [COMPANY NAME] the auditors didn't pick up, So internally you have a bit of a force acting should we or should we not do it. At the end of the day we can do work for audit clients, in certain circumstances we need cession of approval from the client. At the same time we would need to inform the audit partner that this is what we're going to do, is there any reason why we shouldn't do it. There's nothing prohibiting us we should just get the right approvals. It becomes a bit more difficult for an SEC client – United States listed – where you may need audit committee approvals but even locally like Absa for example, because it's a big channel one client, if we do channel two (rest – outside of audit) work, certain listed companies in terms of corporate governance have limited the amount of channel two work you can do for them because they are a big channel one client. Depending on what it is 20% or 25% they may cap you so it's very important to make sure the right checks are done and right approvals are sought. There's nothing to stop us from doing a due diligence on an audit client.

CB - I know that one thing you do and [NAME] has published a couple of versions of a book which is a nice start to understanding what M&A is all about – I get quite perplexed as to how this MBA research project is going to close because from my side I'm trying to show the value or role of brand in mergers & acquisition and I can get to answering that question in more general terms in having discussions with you and the other big four players, but there's no real fixed data that I can find besides analysing



hundreds of due diligence reports on various companies that were done, to show brand featured or it didn't. The brand in itself is such a nebulous thing. It could deal with iconography, culture, so many things so I was wondering, if there is anything within your database that is publicly available, that you think I could use to add substance to this.

RESPONDENT 3 - The easy answer is no – just going back to [NAME] book, what he's really trying to show there is really the trends in the M&A space, what deals were done, the analysis of the deals and who the advisers were and what the passing in the perception of value in the different industries was. You'll get all of that information in the book – how do they value these businesses, what premiums or discounts to the share price – I think there is not a tangible number to put to it and it goes back to the whole concept – a deal doesn't happen unless there is perceived value. Perceived value might be in a management team, it might be brand but the ultimate outcome of all of these elements is value being tangible or intangible, is the cash flows that they generate. We don't split up a deal or do this research where we say this is the value on the management team, this is for goodwill paid, and so on. Certainly, what you'll get out of the book or an assessment of what was paid over and above the net asset value. The bricks and mortar that you can sell today. Everything else is customer relationship, loyalty, brands, products.

CB – How do I get that, lets say since 2005 IFRS rules have been introduced, how do I get a list of deals done in South Africa on public entities that's accounted for in that kind of way, bricks and mortar, intangibles.

RESPONDENT 3 – I'm not quite sure how you'd get it, in terms of published results you'd have to understand where a deal has taken place, look at the financial statements of that business, and they would split the purchase price in one of the notes to say we paid R100 million for X this was the split between the assets and liabilities and what those intangibles were. That should be in published financial statements. [NAME] really do those purchase price allocations in terms of the standards but they also couldn't release it to you just because the client has contracted him to do that, but I'm sure it would be disclosed in financials.

CB - The trick is then for me to find, because the entities may change too so its not always just appropriate to look at the retained entities, that whole structure may change.



RESPONDENT 3 - But generally, if you make an acquisition, in the notes to your financials statements, and your right IFRS was only started for all companies starting in January 2005 so if you're looking at 2006 you would have caught all those events.

CB - So I should be looking at mergers and acquisitions that occurred in 2006

RESPONDENT 3 – Get some financial statements

CB - of those companies and go to the notes.

RESPONDENT 3 – For listed companies that have made that acquisition, they should split that purchase price. I think in the past the value was always just goodwill, now you can see how they've split it. In terms of the principal on how they split it, again it's all linked to cash flows.

CB – Its just a balancing number just done backwards – that's what we paid for the business based on this and the discount rate and whatever else – there's the assets, what's left, how are we going to divide that up. That's the feeling I get?

RESPONDENT 3 – In the split and you can talk to [NAME] to get the details but its around the cash flows that that brand generates. If you're going to value SABC1 you would say, out of the advertising revenue, what generates value, its really the advertising revenue, because people would either pay you to advertise on SABS1 or they would go to M-Net, so that's really the cash flow and the revenue stream that you're discounting at whatever that relief from royalty method is and you have a whole lot of trends and benchmarks that you're using but you're essentially taking the cash flows that that brand generates. **What is difficult sometimes is to split up between what that brand generates and some other one.** In terms of a TV station, its clearly advertising revenue but you may have a business where it's not so clear cut. An example would be software that is developed in-house that is some sort of intangible in the balance sheet but what value is it?

CB – But its not sold – its part of the operating system?

RESPONDENT 3 - Exactly. To the outside person it's worth nothing, its customised to that business but at the same time it must have some sort of a value. So that's where you can get something of a grey line. Its not easy and [NAME] can give you a bit more information around that. I don't think you're going to find it as simplistic as saying well



what was the value of the brand in terms of your research, but **the overriding principal is whatever you're paying over and above the tangible value of the business is the cash flows that are generated by these intangibles, be they brands, loyalty relationships,** what's important is in an M&A deal some of those factors could change. You could buy something with a strong brand and change the name. Apha Cement changed to Holcim – what is the Alpha Cement brand worth – nothing, so they probably could have taken some impairment but at the same time that doesn't impact the cash flows that are generated by the business, all it is, is a book entry against that brand and its really a shift from one to another.

CB - It is, if its done in time e.g. Afgri, all the co-ops, OTK, Natal Co-operative at the time of the deal none of that changed for the customer, There was still a big OTK sign. Over time, once Afgri developed some credibility in the market, it changed. The same may happen with Absa and Barclays.

RESPONDENT 3 - All you're doing is changing cash flows from this element into what relates now to this new brand. The extent of that leakage that would depend on that synergy is and how well it was executed. **If Absa Barclays decided on day one there would be no Absa I suppose they would have lost customers especially in Africa market where Barclays is unknown in that market space.** At the same time if you did cut it what the statement says is you create a brand you allocate a value to it, at the end of each year you must test that for impairment, so in that situation, where you've decided to scrap that brand at the end of the year when you do your impairment test, it must have no value. So there must be a book entry. What your auditors would say is all of those intangibles are now subject to an annual impairment.

CB – Is that like depreciation?

RESPONDENT 3 – This is where the big difference is, whereas in the past you would amortise or depreciate that over the life of that goodwill every year. The statements now say you're not going to depreciate or amortise it, you're going to give it a value and at the end of every year you're going to assess the value. At the end of every year the Auditors will come back and say, that's the value, has it now been impaired to the extent that its impaired there would be a write off against that value but you no longer say its going to last you for 10 years and you write it off after 10 years. In that practice there's been a fundamental shift.



CB – That’s the IFRS3 fundamental?

RESPONDENT 3 - Yes

CB - In terms of access to data base if I do get a list of entities that merged last year – [NAME] said data base is public information – tell me what you want and what you’re looking for – I said I need to do more research with companies to find out what I’m looking for, so I think I have an idea now of where I’m going.

RESPONDENT 3 - Just explain to me what you’re hoping to get out of empirical data out of this database, I don’t know what [NAME] puts in the database, but I know his research team and what they do is they would look at the paper – all deals are published in the Financial Mail. He would say Edcon was sold to Bank Capital for R25 billion, what was the share price, it was a premium of 50%, those are the kinds of stats he would look at. What won’t be on the database is say the R25 billion, tangible value is 10, R15billion and this is how its split.

CB - All I want to get from him is to get that, if it is since IFRS, is a list of all public companies where I can get access to financial statements that have entered into a merger since 2005, that I want – who would the deal makers be and the value, then I’ll need to go and access financial statements through JSE or the companies and pull the notes, information so that I’ll do through other primary sources.

RESPONDENT 3 – What will be there is – they paid so much, and remember, some of these transactions are share deals, cash, combination of the two. Say you get that information what do you want to do with that information?

CB - Firstly to show what trend exists in terms of what’s being paid for, what sort of value above, and I know it will be different for sectors, so you’ll have some typology in terms of sectors and motivation, whether its BEE or trade buy or private equity kind of deal. I want to see generally what trend exists as to what’s being paid above the tangibles.

RESPONDENT 3 – Maybe some of that will be on the database you’ll have to have a look at it but I think by getting those financial and seeing what’s disclosed, you should be able to see they paid R100 million against a tangible value of R50 million, so R50 million was goodwill but then out of that R50million, R10million was pure goodwill, the rest was brands, customer lists, whatever those intangibles were.



CB – From a utopian perspective, there shouldn't be pure goodwill, goodwill should be reduced to zero and allocated to whatever intangibles there are that can be identified and valued.

RESPONDENT 3 – I think in essence though, there will always be, and you could confirm that

CB – That would be interesting and support the findings in terms of these conversations

RESPONDENT 3 – In the past goodwill was a balance number you've now got a whole lot of other intangibles and what's left is still goodwill and how big or small that is relative to what was previously perceived as overall goodwill, you would have to have a look at that

CB – So, you're going to send me your check list – I'll talk to [NAME] just to finalise information in terms of the database and what kind of stuff I can get there.
Can you give me an example of what a due diligence report looks like?

RESPONDENT 3 - I could show you one but obviously it's confidential. We do have a global one that has some guidance which I could share with you I must first see what our protocol is around that. You could maybe come and have a look at it here.

CB – That's fine without taking it – all of this is entirely confidential – none of this information goes into the report – all that comes out of it is the findings, the information related to it and Gibbs or any university not having that confidentiality will just shoot themselves in the foot. There is also a strong relationship between Gibbs and [NAME] in particular – if you want to you can test it with [NAME] or the protocol

RESPONDENT 3 – I'm happy to share it with you I must just make sure the names are out.

Just on the IFRS3 we have certain product cards and one, when it first came out, explaining to clients what needs to be done. So before you go I can get you these examples.



CB – Some of the other things I have here relate more to brand equity, how its valued – they're useless questions because I understand now what you do and focus on cash-flows and not individual lie items.

RESPONDENT 3 – [NAME] would be the best one to talk to about how do you identify what kind of intangibles exist and what are the different methods of valuing those intangibles.

CB - There's no sort of marketing audit or marketing due diligence that's done linking the assets that are created through the customers in terms of the business. A new concept. Marketing due diligence tests, market share, how many customers are out there, who they are in terms of demographics, their behaviours, what their loyalties are

RESPONDENT 3 - I think from our side that would be covered by your operational, commercial due diligence. We might cover it superficially in terms of what is freely available at the client if they monitor these things. **Customer concentration is quite important, we would cover that but we wouldn't do an integrated detailed operational commercial due diligence.**

CB When you talk of Commercial due diligence are you talking about [COMPANY NAME]

RESPONDENT 3 - We generally use other consultants. **They operate in a different space but at the same time we would most probably compete with them on the post deal stuff, they seem to have more market visibility back to pure consulting really and integration issues which we don't really focus on.**

CB – Thank you.

Conversation ends



APPENDIX K4. RESEARCH INTERVIEW – RESPONDENT 4.

CB – General research introduction

I'm looking the at the role of brand in mergers & acquisitions, you mentioned you look at some of it but as you said because of risk you're not that closely involved in due diligence process.

RESPONDENT 4 - We don't do any third party due diligences we let the auditors do that – we will look at the results and debate the results. From a risk return point of view we don't think due diligences makes sense – we think they're pretty high risk and you can't charge that much for them.

CB - What do you means in terms of high risk – that you don't uncover something.

RESPONDENT 4 - You can get sued for a lot of money if you mess it up and what the guys get paid for doing them doesn't warrant the risk.

CB - How do they price it?

RESPONDENT 4 - It's a negotiation.

CB – So there's nothing that's linked to the value of the deal, guidelines or anything.

What I'm finding from a research point of view - two things, number one, there have been some changes in accounting policy in terms of IFRS saying that when a deal is done there is often a balance called goodwill up until now and that goodwill has got to be reduced and accounted for as much as possible in terms of identifying and valuing intangible assets. In the utopian sense there should be no goodwill, it should all be accounted for in some way in terms of what the business is paid for but thats not necessarily realistic in practice. The second thing I'm finding is that, and it depends on the motivation for the deal itself, if its for black empowerment, it may not be applicable, what I'm finding from a research point of view is that when companies put a bit of time towards brand, not just what they call themselves, brand in a deeper element as to what the company actually is - their results tend to be better because they understand the customers that are into the brand, they understand the cash flows that come out of it, so those are the kind of issues that I'm trying to uncover.



RESPONDENT 4 - I think the businesses that are dependant on brand, those businesses should pay a lot of attention to developing and managing those brands and you'd spend time understanding the brand in a deal like that. When we look at a deal we're looking at it in terms of what are the cash flows the business generates on a sustainable basis and therefore what is the value of that business. If the brands are sitting inside the business I'm not worried about how you carve out little bits because it's all in the overall value of the business. I don't care how you allocate the little parts – the accounting profession's got very tied up in doing that in the last few years, I don't think it matters. We ignore it when we're looking at that stuff – we couldn't care how it's allocated.

CB – But you're doing on the basis that you know its there.

RESPONDENT 4 – Yes – we're valuing the overall business which includes the brand. The only time it would matter was if the brands weren't getting sold in which case you would need to value them or if you were only buying the brands – and not the rest of the business. We have done some deals like this, all your Unilever type businesses. One of the deals we've done is the Simonsberg Cheese brand. Now those you need to spend a lot of time and effort getting the brand valuation right – those are few and far between. Most of the time we wouldn't spend time on identifying the different components because the business is worth what the overall business is worth. I'm not worried what they allocated to fixed assets, to brand, to stocks, to debtors, it doesn't fuss me that much.

CB - What is the general process that you go through – how does business start for you – how does the phone start ringing for you, how do you get involved.

RESPONDENT 4 - There's a lot of ways the business comes in – we'd have a client who wants to buy a business could have been that we've been introduced to the client or they've found him themselves.

CB – Does that happen often, are you proactively involved in this? Where you see a balance sheet that doesn't have value you find some buyers or do you think there's more to it

RESPONDENT 4 – Goes both ways, it could be either or. We would then advise the client to conclude a transaction – we'd work out what skills the client has and what we



need to add into it to get the transaction to a conclusion or what we need to pull in from elsewhere if between us we haven't got those skills.

CB – What kinds of things would you pull in, is it more the auditing, due diligence and those things?

RESPONDENT 4 - The due diligence is one, you'd have a legal adviser who would come in to do the legal agreements, you may pull in people with specialist skills to delve specialist areas depending on the business you have and hedges or options you need to get to grips with, and they convert all the instruments into price. It depends on the circumstances

CB - Is your roll to co-ordinate those parties and what value does [COMPANY NAME] bring to the party.

RESPONDENT 4 - We only look at corporate finance, we advise clients on doing a whole lot of things one of which is M&A. So we'd advise a client on how to position himself tactically in negotiations, in structuring the deal from his perspective whether is debt or equity and if he does, then we help him raise that debt or equity.

CB - Then you do the numbers for what is the most optimal structure for him?

RESPONDENT 4 - Depending on what he wants out of the deal there's different reasons whether we issue debt or not.

CB - The motivation in terms of mergers and acquisitions besides which is the obvious which is just growth, rather than incremental or organic growth – those must vary quite significantly between cliets?

RESPONDENT 4 - There are various reasons, this could be a new area of business or they've got a product you want. There could be lots of reasons.

CB - Then based on those the measure of success in terms of the merger and acquisition changes as well, depending on what the initial consideration was.

RESPONDENT 4 - a guy wants key people in his business, it could be loads of reasons.



CB - Once you're down the track in terms of this deal, what considerations do you think are given to what this business is going to become and how do you get involved in that?

RESPONDENT 4 – It depends. For example there is going to be a time when you are buying a business just as a simple bolt-on where you want to generate synergies from your existing infrastructure and you know you can handle that infrastructure and you really just want that infrastructure bolted on. Those deals we do normally, you bring them in you don't spend lots of time on the other stuff – its business you do, you know it well and you're just bringing it into your infrastructure. So those we wouldn't spend long on the softer issues. **When you're bringing in a business which is different to what you're involved in – what you're looking to bring out of the business is different, you spend much more time then, on the softer issues. It depends on what you're after, what you're buying, what you're bringing in, what you need to manage, what resource or skill, product or brand, whatever it is, is integrated successfully into the business.**

CB – How does [COMPANY NAME] play a role in that?

RESPONDENT 4 – Yes – in post deal integration – we'd advise the client on a little bit of the planning upfront, but that would tend to be the client, we'd do the deal, conclude the deal for them, and from then on its up to them to integrate

CB - Do you think there's scope for something like that?

RESPONDENT 4 - I think it's very hard to hand over integration to third parties, it's really **getting the business in to be part of the culture to fit in with the existing organisation, you can't outsource that to consultants or third parties. It's right at the heart and soul of that business. I think the key individuals in the organisation need to be involved in that process.**

CB - They should be involved before rather than after the fact, to some degree the due diligence could become the agenda after the deal is done in terms of what needs to be done to integrate and at what level.

RESPONDENT 4 – They'll be assessing culture fit right through the business, so sure, that is looked at – do the businesses fit, **is there a culture between the organisation and people, are they likely to be part of the deal afterwards easily, so that all happens upfront.** Once you've made those decisions there's still a lot of work to be done to



integrate these businesses afterwards, I think that has to be done at a fairly high level and certainly not outsourced to third parties.

CB - There are a mass of stats out there in terms of success M&A. One guy will say M&A is successful all the time, another will say the person acquiring is always the one making the money; others say about 2/3 fail. What's your take on this?

RESPONDENT 4 – I think you can interpret stats only There are lots of people who have successfully concluded acquisitions. It's the skills set you need to develop and have if you want to do those deals. There are many successful acquisitions.

CB – I don't know if some of these questions are all that relevant in terms of how brand equity is valued in M&A transactions. What do you do when you need to assess a brand, do you outsource it entirely to [COMPANY NAME].

RESPONDENT 4 - What do you mean by assess a brand?

CB - Brand is worth something. What a business does can be easily replicated, what the business is in terms of how it does that, who the people are, and what the structure is, is part of what the brand is. Not just what they call themselves, but its part of the identity of that business. People change their brand all the time because they want to keep it fresh. Heres some values in a recent Sunday Times article – Cola-Cola \$65 billion down to Mercedes Benz \$23 billion – does this kind of calculation ever factor into deals you're involved in?

RESPONDENT 4 - As I said earlier we value the business as a whole. Brand may be a little or big part of the business depending on what the nature of the business you're in. **In the retail space when you're selling to the man on the street – brands matter, in other spaces it doesn't matter.**

CB - Another thing that is said is when that name changes all other issues that are linked to it in terms of loyalty, quality, name awareness, brand association all those things die or need to be revised in some way because the name of the business has now changed.

RESPONDENT 4 - That's the debate you'll have on buying a business – do you revamp or not, change the name or not.



CB - So a lot of these things you lead to the business, they know there are things they are going to have to hit as they move along themselves, you don't advise them on these issues?

RESPONDENT 4 - We have general discussions on it, whether it makes sense to change the name or not, it depends on what type of acquisition you're concluding, if it's a bold one the name's irrelevant you would change it to one big name quickly –

CB - from capacity perspective?

RESPONDENT 4 - move the people out that are not going to fit afterwards, move on quickly and you have to make tough decisions quickly. When you're bringing in something a business doesn't have it's a lot trickier – you spend a lot of time and effort on it. **You need to assess and be very sure if you want to retain the name why you retaining it, what benefit you receive from it, so those debates do happen.**

CB - What sort of stats do you keep in terms of corporate finance and your role in mergers and acquisitions?

RESPONDENT 4 – Not sure what you're asking.

CB – What sort of information would you be prepared to share in terms of the transactions you've done.

RESPONDENT 4 – Besides lists of all our transactions, the information is not public.

CB - nor is my thesis public. I 'm not sure that these questions are relevant any more, based on what you've described.

RESPONDENT 4 – I think a lot of what you're asking is not what our core really is – There is a little bit if we skirt on the fringes of it but by and large what we do isn't in fact what you're looking for.

CB - What do you think of the concept.

RESPONDENT 4 - **Depending on the type of business. Some businesses brand matters, it's the most important thing you've got, in some businesses it doesn't matter, depends on what you're actually buying and why.**



RESPONDENT 4 – It's not an area we specialise in. We know where our core strengths are and where we can deliver value. I think on building a brand and all those types of issues those are all discussions that happen with branding agents and those are the types of people. I think where brand matters the branding agencies should be involved in finding out how strong or weak those brands are, what needs to be done to improve the brand. Can you improve the brand. What's the risk in change of ownership, the brand gets hurt, does the conflict of other brands in the group.

CB - The issue is where brand matters and how to assess that.

RESPONDENT 4 – it's not on every deal but there will be deals where brand is critical.

Note: Although the interview above seems very terse and less useful as the RESPONDENT is not involved in due diligence or value assessments it was at this point that I switched the recorder off. Interestingly, the conversation began to flow and a lot of useful information was gained which is recorded in the research where applicable.



APPENDIX K5. RESEARCH INTERVIEW – RESPONDENT 5.

CB – Maybe if you could just repeat that in terms of Valuation and IFRS.

RESPONDENT 5 – No problem. We would as part of any transaction we would go and do a due diligence – but the buyer of the company they're buying ultimately has to account for that company in its own books. When it comes to accounting for this company there is the goodwill. People want to attribute as little as possible to goodwill to try to identify what other intangibles there are, as you discussed there's intellectual property, there's know how, possibly customer lists and all those things, so that and again depending on corporate governance if we were the auditors to the company, we cannot do the purchase price allocation so you'd find one of the other big four would do it. They would value the business that's being acquired by the buyer and they would look at how they would attribute that value. They come up with their own methodologies, so much to intangibles, there is always going to be goodwill, but the would value those things. From a due diligence point of view, we don't necessarily go and look at those things.

CB – That's the interesting part. The second reason I'm doing it, nevermind the IFRS requirements that are there, is that what I'm finding from academic research and granted more is from the States and the UK, is that when attention is given to these brand issues, or marketing assets, the moment something is intangible it's a marketing asset, when its tangible and it's a factory, its slotted somewhere else – but all the soft fuzzy stuff is pumped into marketing. What they're saying from a research point of view, because its also difficult for them to have done it and the IFRS rules are relatively new worldwide, that when a company puts attention to these marketing, brand issues, their success rates in terms of mergers and acquisition is better. How you measure that success is also nebulous because some company might merge because they just see a good deal, they've got a bit of cash and it might be logical for them to move in that direction. To measure return on equity or share performance whatever it might be, a year or two years later, may not be relevant, others would buy a company because there is some capacity they may be looking for, others would look for clients, we're in the east, they're in the west between us we have some synergies, so to measure success is also a difficult thing. Success is based on what the original motivation was for the deal so they might have achieved it even though the numbers aren't quite showing it yet, so that's the second thing, and obviously from a client point of view, the client will or whoever the parties are that are involved in the transaction, they will face the marketing issues internally – if they change the name of the business, if they put



different customer groups together that didn't know each other before, different products to different customer groups, their reason for going into the merger in the first place, they will have to face those marketing and brand issues themselves.

RESPONDENT 5 - If it's a trade buy.

CB - The research says the sooner you address some of these issues, the better and in fact if you can include or incorporate it in your due diligence and then have it as an agenda item of your due diligence, after the deal, the better, the closer you are aligned. All these good things. So that's really what I'm after from a research perspective. What's your response to that?

RESPONDENT 5 – I would agree with your comment. What we see where the trade buyer...

CB – what do you mean by trade buyer?

RESPONDENT 5 – OK, Someone who is already in the industry and looking to buy another company whether it be for capacity, already operating in that industry ...and what they'll normally do in the mergers because they think their brand is stronger they would just go with their brand and re-brand the business they've acquired. Sometimes that business has got a strong brand and they may keep that brand for a while till they get the message in the market. So, most of the time the trade buyer would do their own work on brand. Because they understand the industry better than anyone else because they're living in that industry. With the financial buyer like the private equity house, were seeing a lot more activity going on – they have an idea of the industry because they have research analysts but they don't know the industry too well so when they come to buy an entity they may consider – what is the brand of this entity, this entity may have six or seven different divisions selling six or seven different products, each having its own brand, then they need to consider what is the good brand to have, do you want to continue having those seven brands or do you want to try and amalgamate and have one brand, so when you go to market everyone notices that brand and therefore they know you for that item. So they're now looking at more and more of that but they wouldn't use someone like [COMPANY NAME] to do that, they tend to use someone who has a marketing background, commercial experience etc. Someone like [COMPANY NAMES] – we've got some industry units and yes we have some industry expertise, but I wouldn't think we have that deep set knowledge that [COMPANY NAME] might have.



CB - If you agree that these brand issues for trade buyers are important, why is it not part of the due diligence process beforehand.

RESPONDENT 5 - Maybe its not distinctly part of the due diligence process but the deals we've done often they talk about brand but the often the guys are say maybe arrogant that they think their brand is better than the brand they acquired – they believe their brand will stand the test of time and then they re-brand all the other stuff according to their brand. I think that's the reason but I've never asked the question.

CB - If you look at internet, academic sources, for due diligence lists, there are thousands, some of them have brand issues, some have customer issues, they've all got tax, they've all got finance there's no doubt about that, then some of the softer issues come to the end.

RESPONDENT 5 - In terms of scoping a due diligence sometimes there is the question, potentially from a legal perspective to try and identify what IP a company has,

CB - in terms of trade marks, registered copyrights etc. They may be brands but they may also not be.

RESPONDENT 5 – Yes, I agree. That's what the legal team may look at depending on the nature of the business. The type of business that lends itself to having patents, brands and IP etc.

CB - When you lead a company in terms of due diligence, is it relatively the same kind of deal all the time or what kind of issues come out?

RESPONDENT 5 - Depends on the industry you're involved in. You're dealing with various companies all the time. Sometimes you're looking at a private equity deal and they're looking at a listed entity. Often a listed entity has all the corporate governance in place, the t's are crossed, the i's are dotted, I think nowadays with listed entities, directors' responsibilities, the guys are concerned so the tend to do things the correct way. When you come to smaller companies the books aren't that great because they're not reported to anyone. They may need it for their banks, so the accounting is different. Issues you pick up are more in the smaller entities than in the bigger entities than a listed entity because of the nature of the way they operate. Normally when we do our due diligence its forward looking not backward looking –



CB - How do you do that?

RESPONDENT 5 - a person buys a business based on its future prospects –

CB - and those cash flows are put into value earnings?

RESPONDENT 5 – Yes, so we'd look at the profit forecast, we'd look at the future cash flows. How do the earnings that are forecast flow into cash flow and out of the earnings that are forecast compare to the history. That's the nature of the work we would do. So it's predominantly forward looking. We'd start stress testing the assumptions that management have made. We don't often bring in the synergies that are identified by the buyer

CB – Because that could change those forecast numbers?

RESPONDENT 5 – Yes, although often those synergies are paid away when it comes to deal. We're finding more and more that people are over-paying for a certain asset because of the nature of the environment we're in at the moment – There are fewer good assets around to be bought because of all those private equity players that come into the market – trade market buyers are often losing out to the private equity players so there are fewer assets and the guys are paying more – so they're prepared to pay more of the synergies away. Now a lot of the synergy work they do themselves. We often don't get involved in that but we often stress test that with the assumptions.

CB - If you're involved as an audit client what is your limitation in terms of dealing with them from a due diligence perspective?

RESPONDENT 5 - Assuming company A is buying B and we are the auditors for company B and were going the due diligence for company B? In terms of conflict of interest and independence. Independence is always an issue so we need to weigh it up – our policy is that as a courtesy we'd obviously go to company B and say we've been approached by a certain player, they often know who it is, to do a due diligence on their behalf and they would like us to do the due diligence – we are your auditors, as a courtesy, we are telling you – its not often that the company turns around and says you can't do it because the person that does the due diligence at [COMPANY NAME] would be a different person that does the audit. Our team is not in audit. We sometimes bring in one or two guys from the audit but we would make sure that the team that's involved



with customer B has never been involved with company B. Then again its relationship issues which you need to understand and need to manage. From that perspective if we get the all clear from company B we would do it. Maybe once or twice where it's happened that company B says sorry, you're too close - were not happy for you to do it, and they would agree with company A, if it's a friendly transaction, the guys will say sorry [COMPANY NAME], we agree with company B and find someone independent to do it.

CB - In terms of the services that you offer those dealing parties, obviously there's audit which could run perpetually with either business before or after whatever the case might be, how often, what other services do you put to the deal after the fact.

RESPONDENT 5 - Post deal – something we haven't ventured into – we've started to look at that. In the UK they have been very successful. There are a lot of things you can do post deal, depending on what the transaction is. If it's a merger, you understand they are going to put the two businesses together – what can you offer them – maybe people can assist them in putting their IT system together, HR experts in understanding what that companies earns what this company earns the culture conflicts and so forth how that has to be married. So it depends on the nature of the transaction. Often its HR related issues, system related issues and maybe accounting related issues that the guys account for things slightly differently. Again it] depends on the industry you're in and what you can sell and this is still something we're still grappling with because there is a market out there to do that and often in South Africa we lose out to the [COMPANY NAME] who get involved in this post deal stuff. That is something we are trying to grow because we see that in the UK they are able to sell that part quite effectively. In the UK I'm talking about [COMPANY NAME], [COMPANY NAME] or [COMPANY NAME] - the big four are able to sell post deal work, in fact they have post deal specialists.

CB - I have been privileged to talk to a number – all the big four – and all of them are looking at it – but not yet in post deal business. There is a huge market there. You will always be taking on your competitors as the big four as well as the consulting firms

RESPONDENT 5 - Its mainly the consultancy firms that you will be taking on.

CB - Even, in fact some of the advertising agencies who are really involved in fluffy stuff are saying we need to get some credibility to our stuff – make these marketing directors more accountable and bring some of this kind of thing into play. You then have brand valuation elements added to the advertising side of things. I suppose its



attractive – worldwide there's a billion worth of mergers and acquisitions that happen every year and that's just the big stuff.

CB - How do you price due diligence –

RESPONDENT 5 - I think it would be standard throughout - we use resources and our resources charge per hour – cost basis –

CB - So you don't charge depending to the size of the deal.

RESPONDENT 5 - Depends on the size of the company you're looking at. The Mark Shuttleworth deal, the due diligence we did on that was next to nothing because he was working out of a garage so they were paid for the brand or the IP, a fortune for something that wasn't really of substance, so the due diligence was small. You take another company where they're paying next to nothing, but the due diligence is big, sometimes the deal value dictates what it is but mostly depending on the size of the company you're doing the due diligence on, the size of it, the number of employees, the number of divisions they operate, it also depends on the scope. Client will say we need this done just look at the balance sheet.

CB – That's all they tell you what to do and that is what you're paid for.

RESPONDENT 5 – Yes, so you've got a list of things that you can do, the client says this is what I want – you try to sell them additional services - we sell time and there's a rate to that time. Often the team that does the financial will do tax as well. We also try to sell legal. We try to sell structuring and the deal documents that have to be done from a legal perspective. What we're finding is that the legal firms are also going for the tax and we're losing out on some of the tax revenue so that's surprising but that's what happening in the market. We price it based on resources and based on the nature of the deal – what the client wants. You have a shopping list of what you can do, offer it to the client, client says this is what we'll do. You meet with the client to find out what their key risks are, you find out how they structured the deal. Do you look at the future or not. If their valuation is based on future cash flows then you can understand what their value drivers are which has caused them to price the business at a certain price. We don't do the valuation but we try covering things that may impact the valuation.

We have started something new and I'm sure all the other guys are going to do it – it is done in the UK and some other countries, in Europe – its with the habitual transactor - like private equity - who continuously does a deal – only guys that normally use us not



just the once off clients. We start entering into a type of arrangement that if the deal is successful we'll draw a certain fee based on time. If it's unsuccessful we'll bill a different rate.

CB – So you're putting a bit of skin into the game and going on risk with these clients?

RESPONDENT 5 – It is going on risk but we try term it not as going on risk because of this **perceived independence issue** because at the end of the day if you're getting paid 120% if the deal's successful or 80% if the deal fails, you're urged to make the deal succeed. **There's the perception that you're not going to uncover something for the purpose of your fee – you only do that with the guys you've created the long term relationship with**, not with anyone you don't know. We're starting to look at that type of billing arrangement. We don't go the contingent base – its similar – if its fails no fee if its successful 3% of deal value time but its more the merchant bankers and corporate finance guys – that's what we're looking at now.

CB – What consideration, and I know you've already said that you know brand is an issue and comes into the business depending on the kind of business, especially if it's a trade buyer – there's always a brand whether well known or not – always a brand that links to a customer in terms of valuation, you stay away from that?

RESPONDENT 5 – **We've never been asked to look at a brand in particular.**

CB – I must stress, when I use the word Brand because I have a marketing background. I use it quite broadly, I'm not talking about the label although it could be just that. I'm talking more about what it is as a business. It depends who you talk to – you talk to a tax guy he talks about a patent, copyright, something he can find, see and register from a legal point of view. If you talk to a marketer he'll say everything is brand – he'll come into [COMPANY NAME] and say the way your offices are designed presents image about you, where you're situated, how you dress,

RESPONDENT 5 – so its more the culture?

CB – Yes, it could be the people, how they operate, how they're trained, so that's how I approach brand – in that kind of way and from a marketing point of view the moment you change something there, you're changing all the things that are associated with that brand – the awareness, the loyalty, those kinds of issues. That's why I think it needs a bit attention. Definitely between the buyers and sellers. From an outside point



of view, independent perspective, if you have the capacity to assess it, maybe do things like marketing due diligence where you start testing clients' loyalties, start looking at their market shares.

RESPONDENT 5 - a lot of that is done via a commercial due diligence and again by the likes of the [COMPANY NAMES] and again it all depends on your knowledgeable buyer – if you're a trade buyer or a financial buyer sometimes you don't have that market knowledge, or if you're someone new into South Africa you may want to know.

CB - Do you offer the service here?

RESPONDENT 5 – No, not necessarily. Something we're looking at doing whether we have the capacity or not – in the UK [COMPANY NAME] would offer that. If you're talking culture it's sometimes in the pay charge due diligence you would uncover that but its very limited its more from a legal perspective so they'd look at legal issues rather than culture. Often for us to comment on culture is difficult. You're going there for a two week period, you have to talk to management a couple of hours a day and for you to make an assessment is that the right person for the business gets quite tricky and that's where a lot of issues arise if you do start commenting on management, a lot of issues, from a risk perspective because we need to manage our risk that's where the comeback often comes back where you've said to the target or buyer this management is great, imagine if it turns out to be bad they'll say but you guys were there.

CB - What about BEE - it's obviously a big driver in South Africa in terms of mergers and acquisitions.

RESPONDENT 5 – When you say what about those kinds of transactions do you mean do we approach them differently

CB – No, I'm sure you don't approach them differently but do the buyer and sellers between those, I mean if there's a merger or acquisition it may not be the whole business, it may be a share element of it. I'm sure the same rigour is going to go into your due diligence process, what I'm after is, between those two parties, the BEE partner and the seller, what's their motivation in the deal in terms of these kinds of culture and brand issues – is that something that features with them?

RESPONDENT 5 - Again it depends on the industry you're in.



CB - Sometimes it's a score card thing and there's no sincerity to it?

RESPONDENT 5 - I think even if it's a score card thing, sellers are realising that without BEE their business might fail. It might be business preservation rather than meeting the score card. Yes, you do meet the score card at an actual point in time, but if you don't meet the score card or if you don't do the deal often a business might just lose all its business and its worth nothing anyway, so the guys have to look at that. **For the seller of the share - brand to him is not an issue because he's selling his share of the business. For a BEE buyer often they're going into that business because of the industry that business is in or the cash flows that business is generating rather than the brand as such.** Brand offer comes in more – because BEE transaction is changing shareholding so it depends on the BEE partner what industry he's trying to get in and why. **Brand issues come in more when it's a potential merger.**

CB – What, from your perspective, is the difference between a merger and acquisition because its used loosely, its just M&A between the two.

RESPONDENT 5 - Merger is when two businesses come together.

CB – But there's always money that changes hands?

RESPONDENT 5 – No, I agree, but say an offshore company comes to SA and buys a company here, it is not a true merger in a sense because that entity in SA is still going to operate as that entity in SA. There may be things they're going to cut out but it is still going to operate – I don't see that as a true merger. True merger I see more two businesses merging so you have business A and B and they come together as business C and that creates additional efficiencies.

CB - There's always money changing hands, may be a CEO that's cut or other duplications that exists, there may be a new brand.

RESPONDENT 5 – The term M&A would incorporate a company from overseas buying that industry **but the true merger I see as two companies coming together and creating one company. That's where I think brand is very key because you have two different companies potentially in the same market space and brand becomes essential.** Yes the brand is also important in the other one but I don't think its essential as that because you still have to have possibly the same management team running this business,



maybe one or two guys change names because now you're reporting offshore or another company in the group.

CB - One thing that's going to come out of this, besides me passing my MBA, I'm more than likely going to develop some sort of model in terms of assessing brand in its broader definition through mergers and acquisitions – when that comes about would that be something that would interest you further in terms of future business or expanding your product ranges.

RESPONDENT 5 - Anything we can develop to grow our business is good – I'll admit this is a market issue and, we are so resource constrained in terms of having the right skills that to try focus on growing the business has become very difficult **because the market is so busy and so active you're running five or six jobs at a time, you don't have to time to focus on what can I develop.** You feel you are reacting rather than being proactive. The market is such now that I would believe that everyone is in the same boat. It would take a bit of investing and identifying a resource saying go ahead and start to invest in the market and if brand is one of the opportunities we can sell them, why not. Again it would take a long time I believe you'd have to buy the resources to be able to sell that service.

CB – What do you mean by buying the resources.

RESPONDENT 5 - You'd have to find someone who has already got the experience in doing that type of work because you don't just develop it overnight. In order to sell that service you have to knowledgeable in that service and have the ability and track record. That's going to be important from our perspective.

CB – Thank you....

Conversation ends



APPENDIX K6. RESEARCH INTERVIEW – RESPONDENT 6.

CB - My MBA thesis is about Brand in mergers and acquisitions. In Carte Blanch there was a skit where they looked at groups who picked shares. The shares were picked by dart throwers who just threw a dart which landed on a share, they looked at nursery school children, school graduates and then the top three investments groups and then the investments groups. They said, pick a portfolio, here are five shares and we'll run it for a year and we'll see at the end of the year who has done the best and the smallest children in the group won. The investments guys retaliated – and said it's a long term game so you have to run it for at least another six months, which they did and the children still won.

What was interesting and maybe this links up later, is how the shares were chosen. When the gurus chose; they looked at shares, numbers, graphs – very analytical. When the senior school children picked they had good access to information and they could to interpret the numbers to some degree. Then there were nursery school children - and the way they chose is they looked at all the logos and the brands because they couldn't read the numbers and they won twice. Their performance was by far the best. What's interesting is not so much what they chose, but how they chose – they chose brands. My daughter is 6, she could say MacDonalds before she could read, she could see the brand and identify it. It's interesting to make a brand connection to how the share performs.

So, in a similar and a long roundabout way, is what I'm looking at is the role of brand in mergers & acquisitions. For the first reason, I think it makes a difference and the research is showing that; and the second reason is that in terms of international IFRS3 since 2005, it shows that when a deal is done, so much goes to assets the rest that was goodwill before now needs to be reduced in terms of intangibles that can be found and identified and measured which is more the academic link to the research itself. What I'm finding so far and what the research is showing is that the companies that are involved in the merger they will think about brand because it may be something they're buying into. Sometimes they have other motivations for buying, but the corporate advisers by and large, the big four in South Africa and maybe some others like [NAME] or [NAME] maybe, but the corporate advisers are not involved in advising in that issue. They look at tax, how the thing is structured, they might look at raising some money, they'll look at a due diligence, that depends on the scope they get and generally its finance and tax related.



So this whole synergy about brand, and the customers that someone may be buying in a merger and acquisition is not brought in by the advisers, the company has to deal with it. They'll sit in their boardroom and decide what to call themselves, decide on staff and integration of staff. The advisers are not getting involved in that level of the playing field – that's what I've seen so far.

RESPONDENT 6 - That's not entirely accurate. On some of the bigger transactions we've worked on you find the private equity guys will typically employ a market consultant, a guy who looks at the commercial aspects of the transaction and they are going to analyse and understand the commercial value of the brand –

CB - The private equity players?

RESPONDENT 6 – Yes. On the corporate transactions I think what you're saying is right. I haven't seen strategic commercial advisers being appointed in an advisory capacity (to consider brand). Two large corporates getting together I have not seen in those, but private equity I certainly have.

CB - From your perspective, what is the due diligence process you follow on terms of a merger and acquisition because due diligence is where you might, if you are looking at brand or market elements, you would audit the customers and look at elements in terms of brand and marketing there. What's to process you follow there?

RESPONDENT 6 - Its slightly different for corporate or private equity, in terms of who we're advising. I'm on the due diligence side and you're dead right, its predominantly financial and tax due diligence that [COMPANY NAME] would get involved in. The second area we get involved in is HR and there are bits and pieces that get added onto it, operational or systems. What we would typically do firstly, if it's a corporate, understand why they're doing this transaction and then focus our review around that. So if it's one corporate buying another are they after products, the brand, the market, the people, try to understand what it is and then we focus our due diligence around that. Going back and seeing that what they think they're buying, that they are actually getting. We would try to analyse the revenue and the profitability, lets say it was the brands that they're going after, Edcon would be an example - you would go and try and understand what brands they have and try analyse that revenue and profitability and that's probably how they would manage the business. If it's a company that's built on brands, you're going to see the underlying management accounts at the end of the year are built up by brands or by a division which is possibly driven by a brand.



We would focus our due diligence around that aspect, understanding that historical trend and obviously on the balance sheet side typically look at it at a group level and what exposures do you have on the balance sheet and what assets are you taking out, your investment in working capital, do an analysis on that. But that historical trend would certainly look around divisionalising or trying to carve up that revenue history.

CB – In terms of your due diligence is it important for you, because there'll be some cash flows that would have been presented at some point of deal, to at worst cost the deal but secondly look at the value that is being put together here. Does your due diligence link to those cash flows right through the business and those are the cash flows that you interrogate more than anything else and whatever assumptions are higher up whether they are brand or certain assets that deliver those cash flows.

RESPONDENT 6 – Absolutely. We'd typically get access to that valuation model and we'd try and give credibility or provide some robustness to underlying assumptions in that model going forward, be that to see if your historical trend is on track or to challenge the assumptions in the thing going forward. In some transactions due diligence is provided purely, not to support the valuation, are there any deal breakers yes or no, it's a kind of a black holes due diligence, your corporate is more going to look at that than your private equity buyers.

CB – What's the difference between corporates and private equity –

RESPONDENT 6 – Corporates, firstly and most importantly is typically going to completely understand that industry and probably already knows the company they're buying –

CB - this is more of a trade purchase, more of an integration kind of thing

RESPONDENT 6 - Yes, either that, or buying that competitor or product or that region, its an add on to their business, and you'll find they've typically come across each other, they know the other guys product, people. So, we're not going to provide input on that, guys we understand that piece, we would rather focus on hidden liabilities we don't understand. They may well say we think that they're strong in their people, or that region or get an understanding of their customer base or who their suppliers are, make sure its not going to compete with us, once we've merged you lose half your customer base, when you thought you were gaining from the merge.



So, those are the principal differences, you need to get that understanding. Corporate may focus it a lot more but your private equity buyer is after cash flow, they'll say go I'm going to leverage this business after buying it go in and lets understand where the peaks and troughs are where is the cash coming from and what can we extract out of this business.

CB - From a client's perspective obviously it will depend on their motivation what's important to them in your due diligence process. What consideration, and it's a broad question I know, is given to a new entity and its brand profile which might result after this merger?

RESPONDENT 6 - We try to be upfront and try to understand why they're doing the due diligence, we almost challenge the strategic rationale for doing the transaction upfront when you're scoping – or, are you coming to me to do a due diligence because you just need to tick a box, you want that thing come hell or high water, and you just need to tick in a box and you can scope around that. Tick in a box is typically go and identify black holes – what liabilities are there that says listen, pay less, don't do it, walk away from the deal. If there's another strategic rationale around doing the transaction as in you want to re-position yourself or you want to re-brand, or you want to use that acquisition target as a launch pad to do something with your business, then you're certainly going to focus your due diligence around that. I have found that the corporates want to hold onto that, that strategic rationale or new product development or new business strategy is typically going to be a director who has that responsibility and he's not going to release it – from the inquirer. The inquirer will be told we're going to launch in that region, this is your baby you're going to be looking after that region. While we provide support to it through the due diligence, analysing the product base, or regional strength, it's going to be building on the back of your strategic plan as opposed to asking us to develop the strategic plan.

CB - Do you ever get called in after the fact to use your original due diligence as an agenda for operations afterwards, in terms of fixing any problems you may have identified?

RESPONDENT 6 - Not often in South Africa. Globally, our UK, European, US and Australian offices are huge in that. They do the due diligence and immediately on implementation of the transaction, they go through that due diligence report, now the guys who've done that due diligence have a lot of information – they focus on what are



the principal areas where you can leverage value and they use them to project manage implementing those aspects.

CB - and it could be anything from HR to systems to legal to tax. I was once privy to one similar to that in terms of a VAT issue – the company saved something like R300 million after the deal just in VAT, just by them putting together structures.

RESPONDENT 6 - If you analyse the revenue that our UK and those regions are generating out of post deal type service, merger integration type service, it's significant.

CB - Clearly that's something SA is going to move into.

RESPONDENT 6 - Its really driven by the size of the transactions, you need large mergers or large private equity transactions as well where there are issues that need to be addressed on date of acquisition. If you look at Alexander Forbes where you've got the private equity fund buying into the thing, there are certainly going to be things that they want to put in place quickly and in a transaction like that there's value in having somebody take ownership for driving the steps 1- 50 that need to be done and its getting the people to do it. To take somebody out of a business and project manage that is typically never going to work. You need to address it in the first three months, otherwise you're never going to get it. If you're going to wait three years you've got no chance of getting that value.

CB - In terms of the private equity players who are the main companies you deal with.

RESPONDENT 6 - The three big ones in South Africa are [NAME], [NAME] and [NAME]. We deal a lot with them. Traditionally haven't done a lot of work with [NAME]. For example, and more and more they're partnering with global funds that are looking to come into South Africa. Edcon was just too big for any of these guys to do it, Alexander Forbes was also too big for anyone of them to do on their own so as a consequence they're forming syndicates on the bigger deals now.

CB - There are also a couple of venture capital spin offs that are going to come out of this whereas South Africa has never been a big venture capital market but its starting to develop to a certain degree.



RESPONDENT 6 - There's a lot of activity, and these guys have raised very significant funds and they're not really in the venture capital space but there are smaller funds that are certainly starting to look at it.

CB - My first approach in terms of this thesis was based on due diligence because from an academic study you've got to try narrow this thing down otherwise you're just going to be searching your hind legs off, so I wanted to focus it on due diligence in South Africa and originally I focused on mainly on the corporate advisers, the big four and a couple of others, but the more I'm getting into this the more I'm seeing there's scope or a role that is played particularly in brand by these guys, [NAMES], those kinds of strategic advisers and obviously I'm now targeting them as well in terms of this content – they may less of a financial or accounting role in terms of those businesses, maybe more of an operational or strategic role, but they do cross paths.

RESPONDENT 6 - We would work very closely with them when they are on the transaction and you necessarily need to. They would employ a strategy consultant, the likes of a [COMPANY NAMES] and we would work hand in hand with them to make sure what we're finding on our side links with the market research on their side and we're actually talking to each other in terms of building that model.

CB - I suppose the next thing we get to, once this due diligence has been done, the next issue is to start drawing up if it is approved and goes ahead, the set of financial accounts in terms of IFRS3. How do you go about valuing, if you do or if you pull in other parties that may do it, some of these intangibles, like copyright, brand, trademarks or even know-how, systems of software so you can account for it.

RESPONDENT 6 - I'm going to pass the buck – I'll give you someone else who specialises in the valuation of intangibles. [NAME]. He would be able to talk you through the process they follow and how they assess intangibles.

CB - Do you agree with the pessimistic view possibly that the value of the business is calculated in terms of cash flows and those cash flows come from all these elements, including intangibles - and that's the number – its still just a balancing act after the deal. Before it was balancing in terms of one big number – goodwill, it still a big balancing act. So now a number falls out and you can call it brand equity – its not done the other way round to say brand is worth x, assets are worth x and therefore the value of the business is x.



RESPONDENT 6 - They do value the intangibles separately and goodwill falls out in the end. You have the exercise of what are the intangibles, there's models and methodology to determine those values and now you say what's the value of the entire business again, goodwill is the number that falls out, but it is a balancing exercise. On occasion you end up with negative goodwill – I've seen a number of transactions like this - so what they're saying is your tangible assets plus intangible assets is greater than what you're selling the business for. IFRS says when you end up with that answer go back and re-check your calculations because you've probably screwed up. So you go back and re-check and say I'm happy with what I've got – so you're buying / selling at a discount.

CB - Has anything ever been tabled with you or possibly some of the international operations in terms of marketing audit or a marketing due diligence.

RESPONDENT 6 - . Market due diligence – absolutely.

CB - Could be - market or marketing due diligence – is that something you would do.

RESPONDENT 6 – Marketing due diligence no – Market due diligence yes. Its essentially the likes of [COMPANY NAME] – its looking at the commercial aspect of the due diligence. It's the strength of the brands, their positioning, who the competitors are, what the competitors are doing, what the company's doing, growth of market share – It's also something we do. A transaction announced last week – the [COMPANY NAME] offer for Gold Reef Casino we did a market due diligence as well as a financial due diligence.

CB - As naïve as it sounds, is their some sort of check list that you have –

RESPONDENT 6 - I guess people have their own check lists – you scope up a thing and then go and cross check it – are there any principal areas I've actually forgotten – we don't have a model approach – we do have what we've built up over the years.

RESPONDENT 6 - Just want to go back to the IFRS3 thing where you end up with goodwill and intangibles – its unusual and its inconsistent in my view on what we doing, or what IFRS requires you to do – because you now call it an intangible and you're putting a value to a trade mark or you put a value to a customer list and you don't do it to what now falls into the balancing thing of balancing thing of goodwill. This one you



have to push through your income statement and write it off where that one just sits in your balance sheets – you've got inconsistencies that end up in your accounts.

CB - What about impairment then?

RESPONDENT 6 - Your goodwill gets tested for impairments to the extent that the business continues

CB - Only the goodwill.

RESPONDENT 6 - You do test your other intangibles for impairment but to the extent that there's value there you still have to continue amortising it so on day one you say this customer list has a life of three years so you're going to have a significant number that appears in the income statement for three years where the piece that you can't allocate to something specific, it just stays there. **As a consequence, people try and leave things in goodwill now to draw down the value of the intangibles because it hits your income statement. So, you've got this inconsistent treatment that in my view needs to be addressed by IFRS –**

CB - Do you think its going to be?

RESPONDENT 6 - Yes I think it will be – it may well be that it may go back to where it used to be in the past – of having a life.

CB - I think the M&A market is significant – its worth \$3trillion last year world wide and that's just really what they can count there may be deals that are on a smaller scale that sunknown. Obviously in terms of this whole corporate governance issue, and ethics and so forth, I think they're squeezing the life out of it – saying, let's try and count as much as we possibly can in terms of investors or creditors whoever it might be for them to understand what the motivation is behind these deals. Some numbers out there are ludicrous and you think why are they paying this for this business – you may still not pick it up, even if it is accounted for in this kind of way. A good intention. The other thing that, a guy by the name of [NAME] , a professor at Wits, recently published an article in Accounting SA, he analysed probably about 50-80 transactions that occurred in the last year that he could get assess to, public accounts, and he says its still not being done even though that's the deal IFRS is on the table, its not being done in terms of the accounts – there's still a significant share of goodwill that's not broken



down – because it should be in terms of the rules, broken down to zero, goodwill should not exist as I understand it. Everything should be accounted for in some way.

RESPONDENT 6 - There can be goodwill but you can't pin to a specific identified intangible.

CB - Even if you could, you may not be able to value it in another way.

RESPONDENT 6 – I think he's getting to the same point I made earlier, where you've got inconsistencies. Some that you are able to identify that now must be amortised and the other piece that just stays there.

CB - In terms of intangible assets how do you account for them in terms of your due diligence - I suppose again it depends on how you scope you have or your role in the business.

RESPONDENT 6 - Due diligence doesn't that often go to identifying intangibles – we try more to understanding the underlying business as opposed to being technical in terms of IFRS, what intangibles are there. We do in many instances do a high level PPA, purchase price exercise of determining what intangibles could well arise, obviously you don't go through that whole purchase price allocation exercise which is done on the effective date, but we do a high level and occasionally we can identify what they are but we not going to spend a lot of time due diligencing because its really is a valuation exercise as opposed to something you need to decide now. Do I do the deal now, how much do I pay for it, or do I walk away, that's really what we focus on. First we make a decision do we want to do it, what do we want to pay in total, and then that's where the technical stuff comes in.

RESPONDENT 6 - Its really a matter of - don't go spending money now doing something you may not have to do because it has to be re-done anyway on the effective date. The DD for Ethos' proposed bid for Gold Reef City – I did that a couple of months ago, the deal is only going to be effective in a couple of month's time and must be done at that point.

CB - What sort of conflicts exist in terms of you doing due diligences particular where there are audit accounts in the mix and maybe it might relate to valuations. There might be internal rules only and may not be legal restrictions – what sort of restrictions exist.



RESPONDENT 6 - There's nothing legal, even the SEC doesn't prohibited us doing a due diligence for a company that you audited, or prohibit us from doing work for an audit or a non-audit client. We have very strict internal policies in terms of managing conflicts that can arise. We may form a view on something that is in conflict with what the audit division, or may pick up an issue that wasn't picked up during the audit, but we have very strict Chinese walls in place that if I'm doing a due diligence on an audit client that audit partner may not talk to me and I may not talk to him unless we follow the exact same procedure that if it were [A COMPETITORS NAME] doing the DD. There is a formal legal process that we follow to get permission where he goes and talks to his client saying I've been approached can I talk to them then its within the confines of the scope of the due diligence, once his client has said yes you can talk to him about it. When a client comes to us and says we want to appoint you because you do the audit, immediately, with my hand on my heart I would say, you're appointing me because I can provide some skill, I have no knowledge of the audit and that audit team has no knowledge of the due diligence, our risk management will not allow me to use any of that audit information on the due diligence so if you think you're going to get benefit, or a shorter process, it will not happen, it will be a completely independent team. You're not going to get any leverage out of me – the only thing you will get out of me is it's a lot closer for me to walk down the passage to set up a meeting with the audit partner instead of driving down town. I'm going to understand the process of the structure of the audit files.

CB - I would assume, based on industry practice, that pricing is done on a time basis?

RESPONDENT 6 – Predominantly yes. We have an internal policy around a risk adjusted fee and there are very small parameters that you work within. We occasionally do due diligence where we're the corporate adviser as well, the M&A side we may have a contingency fee, a success based fee, but on the due diligence piece again it's a very strict, that team cannot be influenced by this team and that one must be time based non success based fee so you pay for the work done the success has to be something completely separate. Again it goes up to the highest levels in the firm to give the OK yes you can have an engagement based on success plus another one that's time based. Otherwise there's clearly an incentive for me to get an OK for due diligence and these guys to get their success fee.

CB – Thank you.

Conversation ends.



APPENDIX K7. RESEARCH INTERVIEW – RESPONDENT 7.

CB – Introductions and general talk

[NAME]. Whats your role in this [NAME] business?

RESPONDENT 7 - I have recently joined, I worked alongside [NAME] when he was working at [PRIVATE EQUITY COMPANY]. I have only been here for two months. I haven't had the full extent or experience of the operations here.

CB - My approach has been private equity although with your involvement in Bain I'm sure you've been exposed to a number of deals besides the strategy element that might be addressed here – that would be relevant, if that's fine.

RESPONDENT 7 - My exposure has been on the mainly on the strategy side rather than on the actual deal side but I have had conversations with him now pertaining to the experience and the [COMPAY NAME] approach and to be honest, the answer is quite simple from him and if you require more then definitely probe him for more, hopefully he'll oblige.

CB - Firstly I'm trying to finish my MBA and as part of that you have to do a thesis and dissertation at the end of it. When did you do yours –

RESPONDENT 7 - 2004.

CB – Great, so you understand this process.....As an individual I come from a finance background but with a marketing ability. I started initially looking at the role of brand in mergers and acquisitions for a couple of reasons the first being that in terms of IFRS that it is law now that when a deal is done, that the intangible components making up that deal need to be disclosed. What used to happen before is a company would buy a business for R10 million, they would ascribed maybe half of that R10 million to fixed tangible assets and the balance they lumped together as goodwill. It could be a number of things that are in that goodwill. Now, in terms of IFRS legislation, in line with governance, ethical practice, that goodwill needs to be reduced to zero rather than unaccounted for in terms of intangible assets like brand, trademarks, copyrights, know-how, even culture although it may not be have an accounting description needs to be accounted for in some way - things that give the business intangible competitive advantage.



The second reason that I'm looking at it is, in terms of the research predominantly US and Europe they are suggesting from a strategic perspective that the sooner companies that are merging look at brand issues, the more successful they are. That measure of success could be a number of things, financial return, integration level, understanding the different customer groups that have come together, product groups or it could be as simple as what are we going to call ourselves after the deal.

What I'm finding so far in particular with the major, the top four accounting and advising firms who do these due diligence exercises, is that brand, or the components of brand is not really something in their tick list. They will go out and find the hard tangible assets, they may feel between the two businesses they are dealing with that there is a culture clash coming, or that their clients are hugely different to the existing clients, even though they think they're in the same market and feel that, it's not something that they really report on but the company will feel it as they get together and they put their new name up and they will have to address it – it'll be part of their first operations exco. In this research when talking to [other RESPONDENTs], [your COMPANY NAME] and [COMPANY NAME] came up a number of times and it was suggested that your role often in terms of M&A is to do more of a commercial kind of due diligence that looks at these issues – that's what I want to explore.

So, Firstly, what kind of services do you offer to parties that are involved in a merge and how you look at the brand and how does it feature in terms of the value it brings, never-mind the accounting side, that will come later.

RESPONDENT 7 - As you mentioned, we offer specific products to private equity houses and the whole due diligence world is multi-faceted. It involves many different types of due diligences. The ones we deal with are primarily the commercial, we also touch sometimes on management due diligences, that would be looking at the management team itself and understanding whether or not they are well positioned to extract the full value of the potential opportunities that business has.

From my understanding that would be involving a lot of time spent with management, understanding their specific competency, experiences, etc.

What we focus on more often is the commercial side of the due diligences and that as an answer, first response, to your question, there is not brand due diligence as such that we do.



There are companies that do brands and put values on brands, brand valuations. [NAME] mentioned [COMPANY NAME] who is the leading organisation in South Africa - pretty much 30% of their revenue is attributed to simply models establishing how much it would cost to re-establish the brand –

CB - and that's the value they use in the transaction?

RESPONDENT 7 – Yes, If the brand was destroyed, how would you get it back to the place that it is at now. Essentially, how much have you invested in the brand. I think it boils down to.

So that's the first point. Commercial due diligence has no specific work stream which is connected to the brand or branding in any way.

CB - No work stream in terms of that brand may or may not feature?

RESPONDENT 7 - No – there's no specific work stream attributed to valuing the brand.

CB - in your structure?

RESPONDENT 7 - In the way we work.

In chatting to a few of the guys here, the point is really that the value of the brand is implicit in the value of the future cash flows because when we value a firm we don't look at the assets as much you actually look at the value of the future discounted cash flows, so I guess the assumption is that the value of the brand is one of the drivers of sales which is in turn one of the main drivers of future cash flows. So the point is really that's it implicit

CB – So, its not a unique approach. A lot of companies in this space operate in exactly the same way. They split out all the mess whether it is brand, culture, management style, yes these things need to be interrogated later on, or audited to some degree in this due diligence however you put it together, but that those assumptions are in there and generate these cash flows.



RESPONDENT 7 - One point one of the managers here made – you have to take it on a case by case basis – if you're looking at a scaffolding business which is really around the product and it doesn't have a strong brand, then you're not going to bother too much about the brand, but if you were looking at Coca-cola or Microsoft then its absolutely one of the things you'd have to consider. So at least there is some kind of qualitative reasoning process that has to happen up front as to how much could the brand affect this process that we're going to go through, but I think that is more of a check list/point, rather than something that would completely derail the process or make you move in another direction. Maybe it just an asterisk or flag to say you take cognisance of this when you look at sales or expected sales in the future.

A few other things he mentioned basically its never been an overt work stream in the commercial or management due diligence process.

CB - In terms of your commercial due diligence, and I'm sure you've already given me the answer because you said its different in terms of context, the businesses that you're involved in, is there a sort of process or check list in terms of what a commercial due diligence actually comprises.

RESPONDENT 7 - There are specific things you would, more often than not, do in a commercial due diligence.

CB - What's the real difference between a commercial due diligence that you might do and a corporate advisor like (name) might do.

RESPONDENT 7 - I can't comment, maybe [NAME] could answer your question.

CB - So, in terms of this check list what kind of things do you look at?

RESPONDENT 7 - I'm not too sure how proprietary the methodology is once again I've obviously seen the internal documentation on the process so it does exist but I'm not too sure to what extent I can actually share that with you.

CB - Could you follow this up with [NAME] on the basis that this is for research and will be treated in a confidential manner. Just to have a look to see what the difference are – in terms of intellectual property, a list is almost meaningless, it's more the way you do it and what you do that really makes the difference and not the list.



In terms of brand at least for you or for the target company that you're looking at when it is a brand that you recognise then it becomes something that you look at. You said that you wouldn't look at a brand for a scaffolding business, I suppose it depends on the position it plays, if you said it for shoes you might have difficulty selling that concept to Nike, or for coffee which is just a commodity you might battle with Starbucks.

RESPONDENT 7 – As soon and you get to FMCG or items or products where there is a lot of brand recognition, then it becomes an issue. I think not so much as right now we need to value the brand inasmuch as how much does the brand strength impact the sales. That's really the first line of your cash flow calculation. If it is a strong driver you need to know the impact.

CB – What are the services broadly that you offer business or private equity players.

RESPONDENT 7 – I'll give it my best shot – I can talk from the documentation that I have seen and what I've been informed but I don't have an extensive corporate memory as to what we've done. Typically we would work alongside the private equity houses and we would specifically provide the commercial or management due diligent services to them. So they would approach us with a target in mind and we would perform the due diligence on that target. Occasionally from my understanding we will look at potential targets and present them but the bulk of the work we do is where the target has already been defined.

CB – In most instances is the target aware that you're doing this exercise.

RESPONDENT 7 – I'm not too sure

CB – I suppose it depends on the detail that you're drilling into and what access to information you need

RESPONDENT 7 – I think often the nature of the business is such that they're not aware, but once again I don't have the institutional memory to comment.

CB – What else did [name]; suggest that we talk about.



RESPONDENT 7 – The main points – two points – and I think I've mentioned them already – he doesn't have a very detailed answer in this particularly situation. The main point; its not an overt work--stream and the second point is that the reason its not is because in the game we play in, value of the brand is implicit in the future cash flows. He said where it's not a merger you're really refinancing an existing business. But obviously in a situation where it is a merger and you get more softer issues coming to the fore maybe it would need to take on a more significant role- whether that really is about brand valuation or whether its about understanding the change processes that will be required, I'm not too sure, as you pointed out more about the fluffy stuff.

CB – There's this huge gap between finance and marketing and the fluffy stuff in between, where marketing cannot justify itself to its board in terms of what it produces in terms of currency, yet to its customers and there's loyalty, quality and all the great things that they exist for and on the other hand finance cannot exist without them and finance just look at the hard numbers. Between the two there is some balance and that's why this kind of thing is coming up. There are things like marketing audits, like brand audits and obviously that's the premise in terms of strategy. Strategy in its simplest form is where we are now – where would we like to be, and the choice of alternatives to get there.

In terms of where you are now, that's where the due diligences and audits come into effect as to what is this thing actually, now, today – then some of the cash flows in terms of taking you to where you want to be and all the assumptions that are built on that and what people are going to do and what the business is going to do and external elements – then, bang, there's the cash flow, there's the price and its made up like this – but in-between there are massive issues – integration issues, soft issues, hard finance issues, but finance in itself is a lot easier to measure and people like that – measure, get a result.

RESPONDENT 7 – I think it's documented that many of the deals that are done fail not because of problems on the financial side, that's all sound, but its all the fluffy stuff in-between that is a basis for failure.

CB – Do you also get involved in that from a strategy perspective as to how to integrate these businesses?



RESPONDENT 7 – I think, on a number of occasions, deals that we have assisted with, we've ended up working with the entity afterwards, to assist them with post merger integration, anything along those lines, assisting with the more on the ground, implementation.

CB – I think I understand, you've got the two questions there, some of these things that I have as questions are not relevant in terms of your business.

RESPONDENT 7 – I'll ask around the methodology, proprietary material – whether we can share some of that with you.

CB – Thank you

Conversation ends.



APPENDIX K8. RESEARCH INTERVIEW – RESPONDENT 8.

RESPONDENT 8 – Are you interviewing me or are we just having a chat?

CB – I'm not really interviewing you no; I think we are having a chat more than anything, as I am still discovering what the main issues are. OK?

Let me tell you what it's about.

What I'm writing my thesis on is the role that brand plays in mergers and acquisitions. What I'm finding from existing academic research is that a lot of guys are saying, particularly in the States is that brand is a critical, critical issue – brand we can define in a number of ways it could just be iconography and what you're going to call yourself after the deal or everything else that comes with it in terms of culture, in terms of people, in terms of how you brand delivery its all those sort of things which I think is the bigger scheme of things and those kind of things need attention when you're going to put two companies together and merge at some point. What they're also saying in terms of the literature, is that when that's not done that well, the chance of success is lower, which makes sense to me.

RESPONDENT 8 - Is there evidence of that?

CB - There is some evidence of that in certain case studies and if you'd like I could send you the information. I found the same kind of response from our local players in mergers and acquisitions that the parties that are involved in doing this due diligence before the deal is done, are generally attorney firms, generally your big four accounting firms and their focus is obviously in line with where their skill set is which is either in terms of financials, tax, legal aspects. For example I've got a meeting tomorrow with the head of intellectual property at [COMPANY NAME] attorneys who have done numerous due diligences and the guy that I'm talking to has a doctorate in intellectual property law so that's how he approaches brand, he sees it as something that is intellectual property, that's a registered trade mark, registered copyright symbol, or something like that, he doesn't necessarily see it as marketers might see it as encompassing a whole lot more of the culture identity of the business. So that's really where this thing is going, so it's going to be quite tricky for me.

RESPONDENT 8 – Its not tricky at all. What is the title of your thesis?



CB - Branding Mergers and Acquisitions.

RESPONDENT 8 – Looks good - I can contribute quite considerably to what you want to do. This week has been a significant week in my life. If you're looking for guidance your best bet and the literature to look at is the accounting literature around IFRS 3. That came into effect in 2005 all over the world and I've just written a thing this morning. I thought of the development of IFRS 3 for almost 15 years via accountants around the world and there is a marketing guy Paddy Barwise - Professor Patrick Barwise. London Business School. I think I might meet him at Christmas, I have a wonderful relationship with his partner in crime a guy called Tim Ambler.

CB - I've read some of his work on Brand Metrics.

RESPONDENT 8 - We're going to have a beer together in London at Christmas. Paddy Barwise did marketing a huge disservice because in 1989 a committee was formed and Barwise was invited to investigate, very quickly in three months, 'should brands be assets on the balance sheet' and the conclusion was they should not and it was rejected so as a result brands went into the wilderness until 2005. Then up comes IFRS3 and there in terms of mergers and acquisitions brands are assets so a complete turnaround of what Barwise said, so you must make a comment on that, that Barwise and his committee - just get report, and you can see how he rejected it and why. Complete turnaround because IFRS3 says it's OK. Do you know Dave Thayser?

CB - Yes. That's who I spoke to recently – I spoke to Dave Thayser and he gave me some information about IFRS3 as to how they would recognise assets in terms of mergers and acquisitions going forward. Until recently Dave had been involved in this.

RESPONDENT 8 - That because in 2005 they brought in the new standard.

CB – Yes, with the focus now on is the intangible separable, all the details are here as to whether or not this is a component of goodwill.

RESPONDENT 8 - there's no question, it is.

CB - OK, so brand, marketing, those intangible assets are all elements of goodwill?



RESPONDENT 8 – Let me explain a bit about IFRS 3. IFRS 3 specifically states that goodwill must be broken down so in a merger and acquisition, if there's goodwill over net asset value it has to be broken down to explain what it comprises and the standards say brand will be will, not might be, will be one, so there is no doubt, it is specified in the guide to the standard, so there is no question. Goodwill must be reduced as goodwill can no longer treated as an asset. Goodwill is the residue after you explained whatever tangibles. Use to be all goodwill now break out those things and its something on its own.

Let me tell you now two things that happened – the one is that I was motivated to write an article and I wrote an article which was set up half an hour ago – in it, with Dave Thyaser's help because he gave me all the mergers and acquisitions activity for 2005, what I did, I took out the big deals from the information Dave Thyaser gave me, there are hundreds of deals, and then I went to Sasfin library, and I pulled out all the annual reports following those deals. IFRS3 says that the report following the deal – it should be reported initially the value of the assets – not there – the accountant ignored it completely, so I've written a stinging article. I'll send you the article. In fact I'll also send you the article in Accountancy SA so you can see those.

And the problem is IFRS3 which is the focal point of what you're talking about, is being interpreted by financial people and not marketing people, financial people are looking at it purely from the way they have always done things so the way they value the intangible assets, the way they consider the intangible assets, don't even contemplate marketing.

CB - How do they?

RESPONDENT 8 - That's another story – we can get to that.

CB - How do you, your business, value brand?

RESPONDENT 8 - Let me answer those two questions, I developed my methodology in the 1990s – it was done as a brand equity tool. It's become now a major financial tool and used by all sorts of people. We've just done the Barloworld unbundling and all the Plascon brands so we are now working for the financial people and some people, but not enough, are recognising that the way we go about it is acceptable. The way that the financial world does it – they use a device called Relief from Royalty.



You heard of it?

CB – no

RESPONDENT 8 – Relief from royalty - what it is, its been used for years and years and I believe [COMPANY NAME] might have created it 40/50 years ago when they were asked to place a value on intangibles – the way the professionals define it sounds quite reasonable. I would define it in a funny way because I think it is nonsensical – it goes like this – If you own a trademark or brand then you don't have to pay any royalties for the use of that trademark. However if you didn't own the trademark/brand you would have to pay a royalty to the person who did own it. But since you do own it you forego the need to pay those royalties therefore the value of the brand is what you would have paid to that third party. It's the capitalised present value.

So now here are the questions.

The first is – what royalty rate - and there is no market in royalty rate so if you take toothpaste, nobody anywhere pays the royalty fees on toothpaste so how on earth do you know what royalty to pay?

Secondly, and don't forget to understand is that brands last an awful long time and [NAME] set up her business 50 years ago and a young son is running it now – it will be there for 200 years - now accountants aren't used to that – they are used to the idea that assets depreciate – they have no conception about brands. For example, Nokia has been around for 150 years, how can you treat a brand in any way similar to a tangible asset, but they do – so what they do, they will take a five or ten year period, they project the earnings for 5 – 10 years bring it back to net present value, then they do an extraordinary thing, then they work out the perpetuity. Well that's what they call it. You know how they do it? You take the discounted rate and divide it into nth year and you get a chunk of money.

CB - But it's significantly diluted – its as if the brand is going to come to an end.

RESPONDENT 8 - Its not diluted because if you take five years of discounted cash flow of front end earnings and you bring it back to present value and you get 100 then you take the fifth year and you divide it by the discount rate, you will, I promise get 200, so the value is now 300 and two-thirds of the value comes from simple arithmetic.

I can't say they all do it but I've been involved in court cases and they all seem to do it. They will take the growth rate of 17% or 35% and they'll grow the turnover, which is another problem, and they'll grow the turnover at the constant growth rate and if you understand the exponential effect and you look at 17% compounded for five years, then you add on perpetuity. I mean what are you talking about, it's just obscene.



The other thing is, it's based on turnover – because royalty is related to turnover – so you take five percent of turnover, deduct the tax and that's the royalty rate. Turnover not profit. Now you can generate turnover easily.

CB – Yes, by reducing the price, who says you're making money?

RESPONDENT 8 - So they base it on turnover. Whereas any sensible business person wants to see what the margins are – are we making a profit? To me it's a completely discredited methodology that they all use. So it's a wonderful opportunity and I'll send this on to you too - there is an organisation called International Standards Valuations Committee IVSC, they're based in London, and they have an expert group, I've looked at the expert group, they are experts, but they're experts in your field, real estate and financial valuation – not one market person there at all and they set themselves the task of defining the standards by which intangible assets, in terms of IFRS3, should be valued in future. A useless thick document, and they've asked for my comments on it by October 31. Because the entire thing is based on a lack of understanding of what intangibles are, particularly brands, as I've just explained to you So if we don't step in and do something, that'll be the way you go about it.

So, your timing is precise. I think you're right about another thing - you've got the brand agencies and you've got the financial mergers/acquisitions people and there is no connection between the two and I've now explained why. The M&A experts view intangibles as yet another asset they do not understand that they come about because of marketing activities and that the only way, any asset, particularly an intangible asset has a value if it has customers and those customers buy regularly and the customers come about because of marketing activities. So its marketing activities that build the customer base and marketing activities that keep the customers loyal to the brand and the income flow which creates the asset comes through to the customer

CB - So the asset on its own in fact has no value when that activity no longer exists. As apposed to a tangible asset as a building will always have some value whatever the market activity?

RESPONDENT 8 - no it doesn't - I disagree with you.

RESPONDENT 8 - the value of a building is the capitalised present value of the leases in place. So you don't have any value unless you have leases. Where do leases come from, they come from satisfied customers who sign leases every five years. So its all linked to customers. I'm teaching at Wits right now, they're all post graduate and I say



this is not an accounting course, but we talk about the Income Statement. I don't know why its called Income Statement and not Income and Expenditure statement but I think its because without any income there is no expenditure. I tell them you own the Income Statement, you own it. Without you there is no income statement because if you don't get customers who are going to spend money shown on the statement there is no income.

CB - Another thing that is starting to develop is this Marketing due diligence, in fact that's probably the last five years, there are references to it before then, but it gains more momentum over the last five years where MacDonald is probably the biggest driver of that kind of activity – where they're saying, yes, do the due diligence but there is another due diligence that should be done, that's the marketing due diligence. How do you feel about that – do you think there's value in that?

RESPONDENT 8 - If you buy into my thesis as I have just explained it to you then marketing becomes part of due diligence because unless you investigate how the company has previously built and defended its customer base you may not have a future so your due diligence really ought to include an investigation of the customer base, how stable is it and what is being done to protect it.

CB - How do you do that – particularly afterwards, the rules may change

RESPONDENT 8 - You now read a new stream of literature on customer equity. I have a huge fight on with customer equity because they claim its customer equity not brand equity that is the value – I disagree with that because I reckon its customer equity that causes that brand to have value – you can't have customer equity without there being some connection to the customer which is through the brand otherwise what have the customers' got, it has to be the brand – there cannot not be a connection. However I do think that customer equity have done a fantastic job by explaining customer lifetime values and all those things.

CB - As a comparison to the relief from royalty model that you describe – how do you do it – I'm sure there's a lot of intellectual property involved – I'm not asking for that much detail what I'm trying to determine is how credible your valuation might be in comparison to the relief from royalty suggestion.



RESPONDENT 8 - In terms of credibility and we are the biggest in South Africa. We've established our credibility because of the companies we've work for. Have you come across Kevin Lane Keller, Brand Management he invited me to write for it, and the third edition – which is huge credibility worldwide.

RESPONDENT 8 - Keller's book Brand Management - should be in the library, the third edition came out last month – within the Financial accounting section and I also wrote a description at his invitation on brand metrics, so that a huge credibility to actually appear in that book which is read all over the world.

The fact is that brand valuation is in its infancy. My view is that credible brand valuation technology has got to make use of established corporate finance tools. It can't be in its entirety because if you're learning about equity, corporate finance is not touched on by brand equity so you've got to introduce some new things, so we use – first of all you've got to look at the economic profit. Economic profit is vital because I can demonstrate through the literature that if a company makes a profit which exceeds its cost to capital then the theory says that is not sustainable because other market participants are now attracted and will drive down prices. That is not the case. There are three indicators at least of companies who have developed and sustained economic profit.

How do they do that? They develop intangible assets which sustain it and one of which will be the brand. So actually brands drive economic profit. Brands plus other intangibles, so we then stumped on that when we developed it.

So we start with economic profit. Then the next thing to do is you've got to carve out the portion that is brand related and we have a methodology for that. That's the one area people could criticise, I think its completely justifiable as its based on a actuarial forecasting technique so its great literature in support of that too.

Corporate clients are not used to it and have to come to grips with the fact that we do this thing, so we actually produce a percentage so we can say 45% is brand or 85% is brand so when you multiply economic profit by that percentage you have what we call a brand premium profit and that is from the audited accounts. Then you have to project that forward for a period of time and we do that based on company budgets, company forecasts, growth rate within the economy you're working on gross GDP, plus inflation within the industry and we take into account seriously the extent which the category, the toothpaste category or the mobile telephone category is able to sustain economic profits for all the participants.

You can imagine what they are. For example if it's a hugely volatile category and there's price cutting, and things like that then you're not going to sustain it for very long. If you're in the cel phone market, it's a licence to print money, its protected. A very thorough examination category allows you to look at entire markets.



And then, market research which incidentally in terms of corporate finance, when you see this discussion paper I'm going to send you, you'll see that market surveys are acceptable as devices for measurement. We reckon that if you do the market survey and the sole purpose of which is to find out how the customers, who as I've explained to you, relate to the brand, what you're looking for there is to see the measurement of relative strength. So the stronger the relationship between the customers of the brand and the brand the more years you'll have in the long term and the weaker the relationship - so you take Vodacom as the strongest brand and Cell C as the weakest brand so you'll see that Vodacom gets the score out of the market research because people think more of Vodacom than MTN and Cell C – it is the strongest brand and the latest scores are 36, 45, 32 or something and that is the relative score and what it does; is its a measurement of risk so in terms of due diligence you'll say that Cell C's potentially got trouble as we know because the relationship between its customers and its brand is weak compared to that of Vodacom.

CB - Are you every involved or invited to contribute to pre-deal activities in terms of Mergers & Acquisitions.

RESPONDENT 8 – Yes, unbundling of Barloworld.

CB – Regularly – what sort of space does it fill in terms of your portfolio

RESPONDENT 8 – We've not done it a lot. It's new for me, but I'm thrilled – its where I want to be - we've done three this year.

CB - Now in terms of this valuation method, so to speak, how does it compare with the Interbrands, or the Brand Finance in the UK?

RESPONDENT 8 - Brand Finance, I wouldn't worry about as it is a breakaway from Interbrand, so model is similar. Interbrand the company has recognised the fact that they are not making enough money out of brand valuation and I think they're not paying too much attention to the ?, that's why I think we could become the biggest in the world, and there are things going on right now which I know that I can't tell you about. I think we could become the standard.

Interbrand have a profound error in their methodology, which I'm going to tell you about. I'm yet to convince the financial world that they should consider market surveys and the actuarial device I've got and they must take it seriously and I'll fight it through



this valuation committee. If I can do that, then ours is completely credible, then everything else about our model is corporate finance.

Where Interbrand differs from us, I can actually remember thinking about this and thinking that's the way to go but fortunately, I didn't do it. You've done corporate finance?

CB – Yes, I did corporate finance and then elective.

RESPONDENT 8 - What you know is that WACC comprises a risk free rate and a beta adjusted premium. That is the correct way to do it. The literature criticised it and ripped it apart but, they all conclude it's the best we've got. It's not ideal, it's the best we've got. That's the way people do it.

So at Brandmetrics we use CAPM we use WACC and we do it precisely on the risk beta's. We do it precisely the way any merchant bank does it.

Interbrand do something different. They saw the risk premium as being related to the strength or the weakness of the brand and that's exactly what I saw ten years ago and didn't do, and they've done it. So what they do is they say risk free rate - what is the risk premium. They then do market research and they do a whole lot of things and they draw a kind of S-Curve. Somewhere they invert their score in the most peculiar way - and that's their secret box.

If the brand is the strongest it could possibly be it has a risk premium of zero. I don't know what the opposite is. Somehow a weak brand will produce a multiple of something, 2, 3, 4, 5, so you multiply the risk free rate by that multiple. So now you get a risk premium of 5, 10, 20, 30. I have no idea of how they get there, and all the other risk premium comes from that curve. So you read it off - say the brand has a brand strength score of 50 then it's 50 points better than zero. **You can see why it wouldn't fly in the face of corporate finance people.**

CB - This is going to come under major scrutiny particularly with the new IFRS3 because it now becomes as it has even though you found that it hasn't been done in this article that you're going to write. But it becomes a significant requirement in terms of Mergers & Acquisitions. The whole world is more governance crazy than before, there's no doubt that not only will it feature but it will become highly topical in terms of the methodology that's used.



CB - How do they link this risk free premium to brand performance – why don't they take other elements of industry, of market.

RESPONDENT 8 - They do they take other elements but I can't have a discussion with you about it, I don't do it, I just don't know.

CB – What is the role for Brandmetrics in terms of these changes, in terms of the IFRS3, in terms of the splurge that's happened in mergers & acquisitions?

RESPONDENT 8 - Brand matrix is used for all sorts of things. It is a primary developed used as a marketing tool and the reason we developed it was because the link between brand marketing and the Board was tenuous to say the least. The board doesn't understand marketing and marketing doesn't speak board. I disagree completely and because of Tim Ambler, I don't think we'll ever – and I can't wait for this meeting in the pub in December – we've had this debate, most of us, but Tim as you know thinks that the Board should use marketing metrics and we should use a battery of them.

People use all sorts of methodologies and I have one – you take an aeroplane, he talks about dashboards, the pilot of the plane flying from Johannesburg to Sydney, he manages the flight - he has to make sure the passengers are safe, doesn't use too much fuel, dodges out of the way of the clouds, he's got massive switches and dials to get from A to B. When he gets to B, he doesn't download or take it to the board – the board say what's our income for the flight, what's our cost and what profit are we making. His job is to use his considerable knowledge and skills during the flight to make sure its safe, efficient and effective and I think the same applies to marketing.

CB – Have you seen MacDonald on that. The argument you're presenting now is exactly what he presents in a book on Marketing Due Diligence

RESPONDENT 8 – Brandmetrics is designed to do that, to reduce it all to a single number that you can send to the board. The value of the brand asset is 100 and we want to spend 3 to improve it. **Don't give them all the marketing gumf** - so it becomes a very powerful tool. To my astonishment, it's now being used for all these other uses I mentioned to you.

CB - Do you think that in terms of this IFRS3 which is really applicable to mergers and acquisitions, don't you think companies will start gearing their balance sheets to be presented in this format on an ongoing basis?



RESPONDENT 8 - Yes, in time, but don't forget that the balance sheet is not changing very much, because the deal is still a deal and all of a sudden you're getting more information on balance sheets.

CB – Top and bottom numbers stay the same?

RESPONDENT 8 - There is another standard which is being worked on but it will be quite a number of years it's called IAS38. IAS38 deals with intangible assets and is a companion to IFRS3 and one day when a company like SAB is compelled in terms of IAS38 to value its existing brand into its own group like Castle Lager, Carling and things like that assets that were previously not being measured will now simply be included. But we haven't got there yet.

CB - Your opening remark, in terms of this title, this is quite an easy thesis to achieve. Why do you say the? If you were in my shoes now where would this thing go?

RESPONDENT 8 - You can write a lot about the development of IFRS3, the significance of IFRS3 and brand is being totally ignored by current practitioners. That alone is important for you to say. Brand is supposed to play a larger role in terms of the people who drafted this thing but there is an ignorance out there and this could be ascribed to the fact that they are not taking into account the marketing activities of building a keeping customers.

CB - Do you think from that perspective that they will either get on track and build these kind of processes, talking about the [COMPANY NAME], the [COMPANY NAME] that they will build that capacity into their business or do you think that they would start looking to outsource it to other specialists?

RESPONDENT 8 – I think it's going to be a slow process. I mean if you listen to the business radio shows it's an hour of finance chat and they really look into the marketing side of it. I think the stock brokers and analysts who he talks to are just born and bred in that language and its going to take a long time for them to understand the way I'm speaking to you but I think that someone like you setting up an intermediary business where you consult to both sides, brand marketers for the finance point of view and you consult to financial people for the marketing point of view – to bridge that gap – I think there's big business and big a future.



CB - If you were involved in this now, you would start focusing on IFRS3 and obviously some articles which you're going to send, would you concern yourself so much the valuation methodology, or do you think that is – because in terms of IFRS3 once you do have classification, how you get to it, what technique you look at becomes critical.

RESPONDENT 8 – You have to have some kind of conception and understanding of how that happens, if only to say that the finance world are missing out on this kind of source, of this kind of cash flow, and the source of this kind of cash flow forecast is the customer, so surely you need to understand how these customers get linked to the brand and how secure is that linkage. If you do no more than pose the question and b) in your final chapter where you say future research so this really has to be investigated and then next years MBA can take that on and do that.

CB - Is it possible for me to gain, without infringing upon your intellectual property, a deeper understanding of how you go about in terms of valuations.

RESPONDENT 8 – You can go to my website – there's lots of stuff there – if you go to the articles on the website, go to article 42 and work your way back I've written a lot of stuff which would be interesting to you, over the last few years and there's a conceptual model which you may use.

CB – Thank you....

Conversation ends.



APPENDIX K9. RESEARCH INTERVIEW – RESPONDENT 9.

CB –The reason I'm looking at it brand in M&A is two fold. From an accounting point of view there is introduction of IFRS International Finance Reporting Standards where what is paid for the business needs to be reduced as much as possible – the accountants report on certain things, so you don't have this chunk of what the business' assets are and the rest is sort of labelled as goodwill in the financial statements – that goodwill must be reduced so you know what was paid for brand, trademarks, for know-how, for certain other intangible assets so that investors know what's going in terms of the company and the second thing I'm looking at is the role of brand its not just iconography and what we call ourselves, it's the entire being of the business, it's what it is. So when you have two companies coming together with a merger and acquisition that whole existence changes and there should be a very thorough process that they go through at due diligences stage. I think they should be actively involved before the deal is done to determine what the brand is and what's going to come out of the new business.

RESPONDENT 9 - That is purely on the basis of value of the balance sheet plus projected earnings.

CB - They take cash flows and say here's a company and what is it going to earn in the next couple of years and they do the same for brand valuations – so this company is going to earn say R1million a year for the next ten years and its going to grow by this rate so that rate we discount to today's value and that's what the company is worth. We take off the debt and that's what the net value of the business is. From a finance point of view that's fine from a practice perspective, the moment there are brands in that business and those brands aren't managed as well as they should be all those cash flows mean nothing.

RESPONDENT 9 - I think there are two things about it. The consultancy is constantly in this dilemma between what you call fluffy and rigorous, and the variance – the degree to which you swing either way depends on the office. So LA branch for instance depends on qualitative new product development, qualitative part market assessment, qualitative brand assessment – it's quite robust in its qualitiveness but generates quite fluffy output sometimes.

CB - How would they be involved in terms of developing new brands?



RESPONDENT 9 – [COMPANY NAME] for example - they create new spirits products in terms of their R&D and product development strategy are willing to develop 12 a year with all the expectation that 10 new brands will bomb - so they don't require the rigour in terms of the development necessary, they require something else but the market will sort them out. In a test market 10 will bomb and another 2 will grow the following year. Other markets and other products in the suite that we have are more robust and more rigorous in terms of their quantitiveness. The next process we offer is something called a Connections audit. That's a highly quantitative technique for understanding how something called brand experience points is derived in a particular pre-defined category through brand contacts with customers. You assess through a qualitative and then a quantitative research methodology and then a very complicated piece of software that's owned by Europe and re-licensed locally, what the Monetary value – what the power of a billboard in the grocery target market is – a billboard versus a word of mouth versus a till wobblers versus a price flash on shelf versus a print ad. That's quite difficult to do – there are some generic measures for above the line. TV reaches this many LSM 8 consumers in South Africa but its not category specific so it gives you no indication whether that's more effective for grocery consumers, car consumers, so this does a proprietary analysis in a particular category and then quantifies the exact cost per brand experience point. So in order to build one brand experience point with a grocery consumer using billboards costs say R180, using point of sale material in store costs R80, using a print ad R270 so it gets to that level –

CB - and what's the value of the brand experience point –

RESPONDENT 9 - its just how ever many points are generated by the study – there's 100% brand experience share available in the category and then the study will tell you how much your brand has – we did an exercise for Pick 'n Pay. Pick 'n Pay has X% the other Y% is divided up amongst the other competitors and that's where the 27% equates to 20000 points the other 16000 and then you work out the cost per point. Now the quantitative value, obviously that gives you a very strong sense, for people spending, like Pick 'n Pay R3 – 400million per year, contacting consumers just through marketing interventions it allows them to make much more accurate resource allocation decisions. The media guys say TV is working very well at the moment. It measures, you can take 35 contacts into the field and only 6 of those are above the line - television and radio sit in the front, outdoor magazines ets - so there's 6 above the line the rest are non advertising contacts, they're outdoor, word of mouth, store signage, etc. The reason, what is the value of measuring these brand experience points is it a nonsense measure made up by the licence holders, yes it is a nonsense measure but



they have now done 1200 such studies and they have an academic validation partner to correlate brand experience score to market share and they correlate directly to each other and incidents of higher than 80% across three tracking periods – you can't just do it at one point in time – track it over three studies then correlate it at higher than 80% in every instance. So there's lots of reason to believe that if you're uplifting your brand experience your market share will follow. If you optimize your brand experience score and invest in the correct points in the correct contact areas your market share will either stop decreasing or increase accordingly.

CB - That obviously is dependant on what kind of products – you're talking about consumer marketing more than anything.

RESPONDENT 9 - It works best in higher involvement categories – if you're doing it in categories like FMCG category like washing powder you get very weak scores because people consider it too low involvement. If you do it in cars or fashion retail, alcohol or cigarettes, even fast foods all of those are sufficiently high involvement for people to know what drives them.

CB - Now, you have a link at some corporate level at least with [NAME] of [COMPANY NAME].

RESPONDENT 9 - Yes the two most robust, rigorous tools in the [COMPANY NAME] suite are brand valuations done by [COMPANY NAME] and The Connections audit. So we have like the core product is disruption which has some quantitative and qualitative inputs, the outputs are sometimes robust but not ever really quantitative, the outputs of connections audit of [COMPANY NAME] are quantitative - all the other tools, processes we use are not quantitative outlets so those two are considered the most robust in terms of the outlets.

CB - In terms of your operations, when you get to a client are you ever involved in doing such an audit in terms of what these brands are worth and the factors that lie behind those brands. Because it's not all advertising you're talking about 6 different above the line advertising avenues as if they're going to take them it's just a matter of allocating how much to which brand. There is obviously a lot more to the business - product wise number one – but never mind that, the people behind it, the distribution, all these kinds of things, does that factor into it?



RESPONDENT 9 - It does in other things. **Connections audit is specifically about brand content that the product or brand makes with consumers through a channel.** Agreed that there are a whole lot of other contributors to brand value separately from that. The research industry in South Africa I think has been better at doing those quantifications and valuations than consultancies have been. So [COMPANY NAME] do things like brand tracker and brand health monitor and things that give you - particularly a tracking pattern of how your brand is performing – well it does an initial study. What are the three brand value drivers for this brand – either that's done consultatively with the client or its done out of the process of asking consumers and then its tracked. So there are eight key drivers of brand value, lets track how well we're doing, for instance when I work with Sasol a range across the company it does exactly that it tracks brand health according to certain indicators. Every six months – this is where the brand is on the 8 key indicators, were up on loyalty, down on appeal, up on the scores and together you get a brand health score that varies every six months of the year. We don't use any particular such tool, So we don't own a tool does that sort of stuff because there's quite a lot of it around in the market. But [NAME] process uses inputs exactly like that, what are the brand value drivers and those are done through his own experience and in consultation with the client what their experience suggests drives brand value and mutually you agree to a list of 12 – 14 brand drivers and then you go to consumers to rate the brand in question and competitors. Rate these brands in terms of attributes in these areas and he then creates his valuation out of both that and other financial data. Then [NAME]'s model would say from the financial guys perspective that's the value of the brand, use that in M&A or valuation discussions or valuation requirements, you can choose to use that rather than accounting brand value. Where we would then pick up on Roger process, because his tool has a piece of software that allows you to do some linear regression, all of these things are curves and generally the software only allows you to do it on linear regression so its not if you manage to uplift the liking score of the brand by say 20% its not necessarily going to drive the same thing because they correlate on a curve not directly proportional. So you can get some education from Roger's software if you uplift it, the liking score brand value will do this, so that's where we'd take over, we'd idea generate. We'd say, we've played around with the tool, instead of trying to make changes in 6 of the 8 value drivers we've worked out that we can make two big leaps in two of the value drivers you can generate this kind of increase in brand value. That's the work we like doing because it focuses the client. Its easy to say to the client these are the 8 value drivers increase the value of all eight then obviously the brand value will increase, but very seldom do businesses have the ability to focus on all eight so if we created massive leaps and that's a disruption, in two of those you would uplift brand value by 25% a year or if you made tiny little



improvements in all 8 drivers you would uplift it by 25%. We would then go into a session where we'd bring in some inside field work and say here's eight, for each of them three potential high policies for how you can drive 50% differences in those two things in a year lets ideate around those and then come back and generate a strategy out of that

CB - The point, in terms of doing that is obviously not just to create value in terms of the brand it is closely linked to whatever sales, whatever loyalty comes out of that brand, it's a sales drive

RESPONDENT 9 – From whose perspective

CB - From the clients perspective. You're not doing this just to create loyalty to the brand. Surely you want to impact sales?

RESPONDENT 9 - We have this discussion with clients at length about this arbitrary issue of improving brand awareness its got very little value unless it relates to income. We try to relate it to bottom line or top line – take an example there's a Valpre mother-brand and four sub brands and we can try drive volume through all four sub brands or we can identify why sub brands although low volume is highly profitable we would drive option around the low volume high profit brand. We don't get completely fixated around sales because particularly in the retail industry you can be selling hundred of millions of things at .01% margin and then you're also wasting your client's time. So we speak about building brands and driving value.

CB - Do you ever get pulled in when a business is going through a merger & acquisition maybe not before, but possibly after the fact, now these two companies have come together and merged their operations in some way their brand identity is conflicted between the two companies that have come together?

RESPONDENT 9 – We get pulled in, I'm thinking world wide and locally now. Various brands need help when want to grow 25% year on year. You get pulled into when brands are in distress or where a visionary CEO or visionary marketing director sees a brand that is ticking over at 5% a year or for whatever reason could be leaping over 50% a year. We don't often get pulled into M&A stuff except when normally when things come to distress – at the time there is an merger or acquisition activity all the concentration is around the very hard stuff – lets value it and pay the minimum possible value and then by the time we get pulled in which could be up to two years later, the



brand ticks over for two years then suddenly some key staff leave, there's one key market down and they didn't realise that the brand is not actually what they bought and its now starting to show. Sometimes we're aware of the M&A and sometimes not. If we do work for Tiger Brands, their snacks and treats portfolio, they've owned some of those brands for ages, a stable of 30 snack/food brands, you don't know which were acquired 12 months ago. Yes we sometimes do, but it's sometimes organically but not every area is related to M&A. It is an area which has been identified internationally where [COMPANY NAME] can add valued. Particularly where the brand is on the threshold of a new future.

CB - that's exactly the point of M&A - its not about organic growth its about acquiring another business now

RESPONDENT 9 – Its about finding new value that not yet been identified, yes its been identified probably a year ago when we were at a conference in LA that there is this very natural synergy between M&A and [COMPANY NAME], as the process – the fundamental principals of disruption – its about unlocking value quickly which is exactly M&A talk and M&A territory and there is an international intent to align our work more to M&A but its not happened yet. We're not actively involved with M&A, deal makers, attorneys, corporate financiers so that we pick up the brand activity. Although its in everyone's head but there's not a lot happening about it.

CB - Do you think there's scope for it in South Africa as well or do you think its going to be tested at other offices worldwide before it gets here.

RESPONDENT 9 - There is definitely a role for it - in my mind its how actively you drive the fluffy stuff and how actively you drive the brand through the metrics stuff. The fluffy stuff tends to involve greater leaps of faith, but also greater returns – if you do a brand valuation study with [NAME] and you value brands and he ran his software and said here's the value driver areas you need to improve, and you do it using ordinary systems, abilities and ordinary suppliers, your company and [NAME]'s stuff will show you you'll come out next year with an incremental increase 10 – 20% better. The fluffy stuff might give you an 80% increase in brand awareness and increase brand value. But at the same time, South African businesses are so sceptical about big leaps – in more developed economies – we for instance are a big leap practice – a lot of the other brand practices are incremental practices particularly the management consultancies who do some brand stuff.



CB - When you talk now of a 10-20% improvement what is improved - these touch points that you have, net income – what does it mean?

RESPONDENT 9 - No it's a hard metric to put in place but you decide up front what are we looking for a 20% uplift in, very rarely is it revenue, because very rarely are you in charge of the top or bottom line, but you could aim, in a particular product line in the region that we choose to make the changes in check the uplift and see if that 20%, or you create a varied measurable third party measure like brand experience points and create a 20% uplift in that and we have reason to believe that over time that has an 80% correlation to market share, or we can create a 20% uplift in the brand value as determined by Roger but we're never in control of the top or bottom lines, so its difficult to make these promises.

CB - Is your focus more on corporate brands or on product brands, or does it not really matter to you.

RESPONDENT 9 - I suppose business to business brand and business consumer brands applies to towards consumer brands and sometimes it is the corporate brand Barloworld versus CAT or something - because consumers tend to engage in a product brand more than they do in a corporate brand. Try tell Tiger Brand to spend money developing their corporate brand, it's a waste of time for them, they do it bit by bit but their budget is split up amongst their product brands.

CB - Then you have another example like Investec who spend £30million a year and their market is predominantly corporate even though their market goes to consumer market in terms of what they spend money on it filters through on a corporate level, so the strategies can be vast.

RESPONDENT 9 – The other thing we don't do, we do a little locally but they do a lot in Hong Kong and even in LA is **developing employer brands and we have a process for doing it here, internal brand alignment where it does some work around the brand at consumer level or regardless of the consumer stuff you're still not attracting good talent and then we have a process for the company to make themselves more appealing as an employer** brand. It's a massive problem in high growth markets, its not finding the customers, if you build it they'll come, its delivery after you've attracted them because they only come once. They battle is to attract the right talent.



CB - Is brand equity an issue in terms of the space that you play in, is that a word that is bandied about and understood.

RESPONDENT 9 - We don't use it a lot because it was originally penned by Ogilvy.

CB - Not really, its actually an accounting term – maybe Ogilvy put a lot of noise behind it.

RESPONDENT 9 – Everyone uses their own words, we use the expression 360 degree communication for some time, but it's become generic

CB - So what's your equivalent to brand equity, there's owners' equity, there's shareholders equity, equity's a worth, so what's yours

RESPONDENT 9 - We use the expression greater share of the future, that gives an indication of fluffiness as well is or isn't it appropriate. Disruption is about harnessing, leveraging processes that allow you to secure a greater share of the future, so that might be in a different brand might be in different markets with a different customer profile than your current one, greater share of the future, might represent exactly the same top line but a massively different bottom line so that expression we use but we don't have a coined term for what is the importance for creating value in a brand, we believe in the value of brands intrinsically and driving brand value because everything we do is in some way, even if it is an internal alignment exercise, a culture exercise, it is always around making brand more valuable either externally or internally. We have a fundamental belief in brand.

There is more literature about the enormous dollar figures they put next to Googles and Microsoft and GE brands, and we use that in our presentation as well to see if I spend the R5 million on a brand project rather than building this plant, what will it do, how will it financially influence the future of my business.

CB - Can you determine that?

RESPONDENT 9 - we can't – we sometimes can – with a lot of the predictive stuff we can, with things like connections audit we can if you shift the R5million out of here into this brand score and the correlating market share increase over the period would be X. With Rogers stuff you can show the return on investments using his modelling software when you put R5million in over one year you can generate R12million if you can put it into these value drivers and you can then assess that against building the plant. That's



two out of nearly 12 kinas inputs, and also the cost to benefit ratio is quite low so running a full day disruption or a brand disrupting process with us might cost between R100 000 to R250 000, and we say we think its going to have a business benefit – if that ends up being the case and the marketing director, Brand Manager, CEO gives us the R200 000 to go and do it, even if it has a .01% uplift on a significant area of that business, it pays for itself hundreds of times with a strong brand for example like Standard bank so then they'll take the risk. Now the cost to benefit ratio is favourable. But when we say we want you to shift R10million worth of spend then they want to see some numbers around that, some result.

CB – I think the rest of the stuff I have here is more accounting based – in terms of certain intangible assets, how they valued, how they dealt with. Maybe one other thing you might be able to give me some insight into is - do you ever get involved in a marketing audit or a marketing due diligence kind of process. Part of it is saying - our marketing efforts as a company are right and aligned and we want you to make sure that they're in place secondly what are we spending – are we spending enough money to get the right value for our buck and a third one do we have enough brand metrics built into our business so show the board that marketing is actually doing OK. Those are the kinds of things that come about in these marketing audits and marketing due diligences processes.

RESPONDENT 9 – We don't ever get pulled in to form due diligence exercises as might be required like you break up various streams in an M&A where marketing is one of the streams and some due diligences is part of the exercise, but we do both market assessments and marketing assessments – generally we do them quite loosely, generally because they are commissioned by the same client, to present back to so its not such a knuckle wrapping session - we see opportunities

CB – As a stand alone product?

RESPONDENT 9 – Yes, Play-station would say - we don't know enough about 13 to 18 year olds, teenagers, we want to know everything about them – we want to know what they're like, why they use these gaming products and then they'll do a market analysis and just present that stuff. We generally do it as a phase that feeds other things that we do and on a more rigorous side we've got a check list and a clip board in terms of physical due diligences type exercise we almost never do.



CB - It also seems just from your description that you're not involved in strategy formulation even from a marketing point of view but that you'd be the expert that would find information, research information but you deliver it back to the boardroom and they're the party that implements it.

RESPONDENT 9 – No, very definitely not. When we collaborate on a connections audit with a research partner the value that we add is that we own the license internationally. Big dollar license fee attached to that. The research company you pay a lot of money to do the research and frankly if you plugged the research data into the software you're probably 75% there in terms of getting the output. We do the pre-consulting phase, we arrive and ask what, why you doing it. What triggers should we be aiming to analyse when the data comes out on the other end because the research house will comes back and put up the 12 bullet point list of conclusions and recommendations and then you must just go and do it. What we do in the post consultant phase is a whole lot more collaborative stuff where we pull execs into workshops and we don't just do fluffy ideation stuff – what are the variable business opportunities and thrash those out now so they can be implemented. We're definitely much more involved in collaborative strategy that can be implemented than just throwing up lists of recommendations and hoping somebody will run with it. Cellular work in Africa– ongoing involvement - you arrive there do brand alignment strategy then six months later 2008 communication strategy. Its very rarely insight gathering, presenting, walking away – inevitably its longer term involvement with the client. Where you need to be held accountable for what you promised or you have at least collaborated them to come up with some actionables. Like...How is it possible to make this happen in your business, how do compile a strategy in a plan, rather than us to say what we foundits always more strategy bound than it is just recommendation.

CB – Thank you
Conversation ends.



APPENDIX K10. RESEARCH INTERVIEW – RESPONDENT 10.

RESPONDENT 10 - I think there may be two main reasons for putting you through to me – quite honestly, within [COMPANY NAME] we're lacking in indepth marketing in field knowledge which you have stated in your report, we are very operations driven and secondly in the research that I have been conducting within [COMPANY NAME] I have been heavily involved in the branding issue which is really around understanding brand, testing brand drivers and everything else and also developing a proprietary approach to valuing brand. I'm not really in the M&A practice, I'm deeply involved in the topic of branding.

CB - Are you seeing that there is more and more a deeper requirement in terms of your of the clients you deal with obviously from a strategic perspective to put a value to the brand and not so much a marketing exercise that might surround it and improve its value.

RESPONDENT 10 – Absolutely, there are two trends that we are observing, first of all the brand as such is gaining momentum and is being recognised as being one of the most important intangible assets the company may have. So far, in most companies, at least in Germany, brand was associated with advertising and that was about it, the understanding is now that there is more to the brand in terms of its attributes and economic impact that it may have which is actually quite important - that is why, in recent years we've had pretty broad discussions in the marketing area around brand relevance. How far is the brand really relevant to driving the customers decision making process, and we found that it varies from industry to industry but over and above, with very few exceptions, take monopolies for example where you have no choice, brand does play a significant role when it comes to making your choice. We really came into this space trying to understand how we can actually value the brand and how we can improve the brand valuation and that has been quite interesting because within [COMPANY NAME] Germany we analyse a couple of M&A activities and we came to the fact that on average, something between say 60% – 70% of the total price being paid for companies – if its an acquisition – is actually attributed to the brand – where there is no tangible asset whatsoever that is actually being purchased – it must be the brand.

CB - Although they've probably called it goodwill.



RESPONDENT 10 - Yes. You can now relate it to your balance sheet so you can write it off so to say but we would put it, under German law, as goodwill into the balance sheet. The only trouble at this point in time being that especially when it comes to re-valuing the brand in the following years – at least you want to make an effort to strengthen your brand – there is not a single approach, legally accepted by auditors, to actually assess the value for brand. This is causing quite some difficulties here because you might have a value called goodwill recorded in your balance sheet you might write it off over time but you actually have no way that is officially accepted to check the value of your brand all the time.

CB - Are you saying that at the beginning of the transaction they might ascribe the value of the brand to goodwill – then the goodwill is written off as a line item so to speak on the balance sheet, but it doesn't mean that the brand has been written off? The brand still exists.

RESPONDENT 10 - Absolutely – they would write it off as an exercise for saving tax.

CB - Broadly speaking, what are the services that [COMPANY NAME] offers its customers.

RESPONDENT 10 - Essentially we are in the field of management consulting and we do have a pretty large marketing practice especially in the States and Europe we offer advice on everything concerning marketing issues – we are not a branding boutique, we are not an advertising boutique, we do not have fixed programmes that we sell – it's more like the CEO addresses us over various issues asking us to support them with that but its not as if we're selling a specific programme of service that we've developed that we roll out or apply to different client situations, that means that the range of topics that we service our clients with covers everything between pricing, loyalty management, consumer insight, commercial transformation but increasingly the topic around branding which I guess, not disclosing any internal information would be something about 30% of our total consulting hours charged to clients within the marketing field. So that is quite significant. Within that there are essentially two issues, first of all with regard to branding would be understanding the trends of the brand, so at [COMPANY NAME] we always follow the situation, complication, solution approach; which is the basic approach that is to say that whenever, because I was reading your question before the call and you ask how far do we assess the status of the brand before doing anything else, and we would naturally always do that because we believe that creating a transparency and having an aligned approach, what are the current



strengths and weaknesses of my brand by segment or unit. That is actually achieved before going into any further discussions. What we do normally is do some engagement on strengthening the brand which is usually about re-defining or shaping the value proposition.

CB - re-position?

RESPONDENT 10 - and making sure that we address the issues that is relevant for the specific target group. Some companies tend to do everything and promise everything to the customer regardless of whether they have the capabilities to fulfil that brand promise, and regardless of the fact that that sector is more of a hygiene factor so it's not differentiating; and that's question number one. Then question number two and that links very well with your topic around marketing and brand approach. We are heavily involved in the process of how we can assess the developing of a brand over time because building up a strong brand is fine if you want to do it on a qualitative basis that's also fine because you would then have channels to check the development of the perception against certain attributes but that is not sufficient because what you want to know is fact based, quantitatively what is it that's changing. Especially for the European market being in, moving quite rapidly, a lot of M&A activities going on, we have a lot of clients, but also former clients who suddenly call us up and ask for a brand valuation, to just make a point, when it comes to making a decision from the brand portfolio, their brand is not being abolished and actually have some value attributed and they're increasing interest of quantifying that.

CB - So, you're saying a lot of your work is involved in brand valuation so that when these mergers are anticipated, discussed, that the actual naming of the new business can be debated on a more practical level in terms of that valuation.

RESPONDENT 10 – Exactly.

CB - Obviously from a research point of view, the moment that name is changed, any brand equity that may have existed, although it won't be lost entirely, it certainly becomes diluted because there's a new being that's come into existence, a new culture, a new delivery mechanism. There are case studies world wide where that's happened and hasn't worked.

RESPONDENT 10 – Exactly.



CB - Is your role as [COMPANY NAME] from a marketing point of view, are you closely linked to the other suite of strategy advisers within [COMPANY NAME] because obviously there are different levels and different specialisations, or do you focus mainly on the brand side of things.

RESPONDENT 10 - I, myself focus mainly on the brand side of things and when it actually does come into play, then I would take care of the transformation element. Once the decision's been taken how can we migrate companies into a more consistent, powerful delivery system. There are others though, we do have a practice that deals only with M&A only and they will have a much broader spectrum and call us in when topics such as branding but they will take care of all the other aspects.

CB – They would integrate with you

RESPONDENT 10 – Initially, how it would work if you're talking M&A, a company would call us up and ask for a due diligence. On a specific topic of branding, like an insurance company they will be providing the overall advice on M&A and then call me to do the brand evaluation for the company being acquired, and then the recommendation if that brand should be abolished in the first place or abolished over time using co-branding facilities or endorsements, whatever.

CB – Does that mean that your involvement with the company is certainly more long term and more strategic than the M&A guys who might just go in there initially to structure the deal, put together finance and tax benefits?

RESPONDENT 10 – The core belief at [COMPANY NAME] is that we never want to be transactional. I think it's fair to say that a lot of M&A companies are too transactional and that's often how the bonus systems will be structured. For us it's entirely different we work on a relationship basis and we will involve in M&A studies but only for long term clients – I think it's around 70%-80% of our total turnover in Germany it's actually traded with clients we've served for more than 5 years. We really heavily depend on those relationships and obviously with an important question of M&A coming up, we will provide support, but we will not come in only for that. We will at least try to be engaged in the implementation and realisation.

CB – How long has this Brand division within [COMPANY NAME] Europe and USA been in existence.



RESPONDENT 10 – 5 years

CB – Before that, what would have occurred in terms of brand valuation or these kinds of issues that you speak of to engage the client on a longer term basis.

RESPONDENT 10 – Quite honestly, speaking for Europe it was not on the top management's agenda. [COMPANY NAME] is typically an generalist management consulting firm providing advise on all different forums now we recognised about 15 years ago that there was an increasing demand for deep functional expertise such as marketing, operations or risk management that is why we established so called practice and marketing sales practice is one of the largest ones we actually do have.

But then again there was another acknowledgement that knowing something about marketing is not enough you have to know the detailed trends, so that is why, under the umbrella of the marketing practice we established so called service lines of which we have seven currently. Only from that point of time, since developing some knowledge and expertise with regard to these specific topics that we actually do have some valuable knowledge of, that we can take to the client. About 2001/2002 we had an extremely broad discussion in most European markets around the relevance and approach of managing a strong brand because we came to see that in mostly saturated markets you really have to make sure that you understand your customer very well and know what lever to pull in order to differentiate yourself because from product quality, from a rational point of view, most of the products are extremely similar and only price is the differentiator.

CB – In terms of your model to value brands, I'm sure that there is a lot of proprietary or intellectual property around that, but is there a specific model or approach that you use that you are able to disclose of what sort of process you follow to value brand.

RESPONDENT 10 – I can send you some charts with the approach, with the formula and a couple of real life results. I can send it to you and if you want to show the model in your thesis that shouldn't be a problem. We publish it ourselves in academic magazines; just recently we also published a book that is now also public knowledge so we have no problem at all if you put it in your thesis.

CB – May I ask just out of interest what did you do your doctorate in.



RESPONDENT 10 - I did my doctorate in Branding – I analysed the importance of emotional brand attributes so together with what you're saying we have come to see that rational brand is perceived as not being that powerful anymore that's why a lot of companies in Europe tend to use very emotional branding, very emotional attributes, very emotional driven advertising campaigns. We were in doubt, it was a mega-trend, it just seemed too simple, so what we wanted to understand is building up an emotional brand, when building up a strong brand, in all industries and in all purchase stages - Its an entirely different question than if you have trouble being purchased than if you have troubles around loyalty.

CB - What did you find – that it was that simple – that it was enough to distinguish them from their competitors by just switching brand plan or moving into a more emotional field or were there more elements to it.

RESPONDENT 10 - It was actually more complex in the end, but bottom line was yes emotional attributes can be quite powerful but you have to well understand where the bottleneck of your brand will be. We found four very complete clusters that companies could use as guidelines to find an efficient trail between rational and emotional brand. But over and above we would never recommend based on the findings of the doctorate to concentrate on rational attributes only or to concentrate on emotional attributes only. We always employ a certain mix and that mix will actually differ by a percentage of your brand.

CB - Is there a similar kind of business in South Africa in terms of your marketing and sales practice that is developing or is there demand for something like that that might develop in South Africa.

RESPONDENT 10 - Two observations – **having worked in South Africa for most of this year I see that marketing issues are increasingly relevant** for companies in the market because you are moving so rapidly and I think there is an increasing need of really understanding consumer segments, its not as easy as it used to be and I think the branding issue as well is getting quite interesting. When I was there I was telling one of the large banks that we had so many discussions not only within the bank but also a whole lot of other clients, I was having trouble making all these meetings because there was so much demand which we at [COMPANY NAME] were unable to service.



CB - There is huge demand here – in terms of M&A on its own and that in itself is the significant trigger to re-evaluate brand strategy obviously very closely linked to integration elements within the rest of the business, but just in terms of that during 2005/2006 there have probably been about R500 billion worth of transactions here – and I'll send you some of the details in terms of what I'm studying. In terms of advertising and this is just above the line advertising, South African advertising agencies generate R20 billion worth of spend per year. It doesn't mean that advertising is brand but they're obviously closely related in some regard; but there is a very buoyant, very aggressive brand and sales market in South Africa, there is no doubt about that. It's interesting for future growth from your perspective.

RESPONDENT 10 – If I had a choice of being with [COMPANY NAME] in Germany or South Africa, I would consider moving down. Or being self employed I would definitely recommend you do something around branding or brand marketing ROI approach, how to value, how to manage and build up strong brands, how to make sure how we can understand all the elements

CB – Its interesting that you say ROI because there is also another theme that comes out of this and that possibly why things are just dumped into goodwill and haven't had the credibility they've had up until now, is that marketing doesn't have credibility at boardroom level until you reduce it to a number like ROI, like a valuation.

RESPONDENT 10 – I think that's a great contribution and you and me working at it can make marketing a bit more tangible and quantifiable and if we can actually manage our approach that would be a great step ahead.

CB – In terms of the clients that you deal with, after the M&A has occurred how do you find that they handle or integrate branding and intangible asset elements. I know it's a very broad question so if you want me to define it I'll do that. I'm assuming two companies have come together and they've decided on a brand strategy to move ahead and there are so many elements that can affect that brand strategy. How do you find they handle it and what sort of role do you play in that regard?

RESPONDENT 10 – Integrating of brands obviously means not only integrating the brand name but integrating a whole different business system which ideally is on the line with the respective value proposition which each of the brands would have. Now reflecting back on a merger of two insurance companies here in Germany, which we just had, we actually abolished one of these brands and it was extremely difficult to



actually tackle all of the issues because here the intangible brand isn't quite established, so we had to deal with all of the processes because one of the insurance companies being positioned as one of the innovative industry leaders and the other one being more of a don't-work-it, simple, easy to understand insurance for simple people, working class in Germany and **it was quite a challenge to bring these two businesses systems together which has obviously affected not only sales and marketing but all of the underlying processes with regard to contract management. Service management and so forth.** That was actually the main challenge but also the intangible side of the brand, which is the motivation and identification of the employees was quite a challenge and therefore when we're going in we also have the approach to tackle the issues around the business processes, yet they must have the capabilities with an underlying element of management infrastructure which is around checking the processes.

CB - Obviously from a timing point of view and I know this will differ depending on what the scale of business is all these different businesses, **but something like that must take a number of years and obviously a quite a change in turnover of staff as well and even in clients to start coming right?**

RESPONDENT 10 - Yes – most definitely. We see different situations and I guess it depends on how close the former business systems would have been, and particular how well the integration has been managed. We had another client which was pretty successfully integrating with a major competitor they acquired, in about two years. But that was the fastest integration that I've seen to date. I think that's one of the key factors why acquisitions not managed turn out not to be successful as anticipated.

I think broadly speaking, anything below three years would probably be non-complete or a non-welcome integration because it just takes too long to change peoples heads and transform the entire business.

CB - and obviously to change the consumer's perspective as well.

Do you find that these kinds of issues are discussed pre M&A before the deal is done, or is it something they know is going to take 2 – 5 years or whatever it is, to get through it. Or is it something that's on the agenda in terms of what they're going to do after the fact?

RESPONDENT 10 – To my knowledge it is definitely discussed but on a very broad level such as an acquisition tends to fail, or tend to not deliver the entire value because of. Most of the people you talk to would be so convinced that this might be the case on



a broad basis as research suggests, but its going to be different in their case. So, a lot of people would assume that they will do a better job in integrating the other company and are not impressed and secondly we also see, in the States and Europe, a lot of acquisition activity is being driven by delivering a good story for the analysts. I just had a case this week where I was questioning the sense behind the acquisition, they needed some sort of international element in different fields and that is why they went out and acquired another company. Without them believing that they would be capable of integrating or creating sufficient value.

CB – So, what's the point

RESPONDENT 10 – Probably some CEO under pressure

CB – and he has to show he has some plans and he's active – whether they work or not

RESPONDENT 10 – I think it's more about show than anything else. That would certainly be something one would never be involved with because we have a strong point of view, if the client does not agree we will not engage and that's a pretty comfortable situation that we have at [COMPANY NAME]. Again, we also believe we should be relationship based and this specific company will have no difficulty finding an Investment Bank closing a deal for them.

CB – So, they want it at transaction level.

As you mentioned earlier, these brand kind of issues and possibly other intangible asset issues are discussed before the deal is done on a very broad level. Are you ever asked to put together some sort of marketing audit, or marketing due diligence or even some other commercial due diligence that has these marketing integration issues – client evaluation issues might be one of them, positioning analysis and so forth together, before a deal is done. Is that something that you currently do or would consider doing?

RESPONDENT 10 – I know one case where we did it quite extensively.

CB – What would that be for you, is it like a marketing audit or marketing due diligence.

RESPONDENT 10 – I wouldn't know if there is a specific format for a marketing audit but I think what I would understand the audit to be very close (to your description)



because it was a very thorough understanding of what was needed. It was a two or three month study before doing anything on the merger side really is testing the brand thoroughly and writing a marketing synergy on that.

CB – But, as you say that doesn't happen often or not often enough perhaps?

RESPONDENT 10 – No – not really

CB – So are you then more pulled in after the fact whether its an M&A transaction or some sort of disruption that's occurred in the market or with the clients, are you normally, although as you say 80% of your clients are long terms clients, but for new business, are you normally pulled in after the fact where they say "we're in this position now, help us to get through it" – that kind of issue.

RESPONDENT 10 – That's a fair question and fair to say that probably you're right. In those instances where we have a close link with the organisation we may the possibility to engage further or at least show them the red lights and to alert them to what must be done upfront. In a lot of situations though, it might be the case that for whatever reason, not being pulled up front and then we would see something going wrong and then save whatever is possible and be pulled in later and do whatever is possible at that point in time.

CB – I don't want to put words in your mouth because its my statement but if that's what it is then it confirms a lot of what I've seen in terms of the academic research.

RESPONDENT 10 – It's an interesting perspective and I guess you could argue that, especially when it comes to consulting companies now, speaking broadly not only in respect to [COMPANY NAME] you could argue that I think they're quite expensive in nature anyway that clients might start to task investment banks than rather have the consulting companies do the integration work. We know a lot of examples where this is not been the case but then again we have a lot of long standing client relations here in Germany and we would be so deeply involved and integrated into the client organisation that we would automatically be involved – official engagement or not, but I would guess that other instances there would be a tendency to closing the deal and then calling the consulting company.



CB – I think I have what I need – are there any other things you think I should be considering, looking at, or picking up just in terms of your experience and studies that could put a bit of meat on the bone in terms of this study

RESPONDENT 10 – Not that I can think of just now. I would just like to reiterate the point that I really like your idea of really driving the branding issue which are sort of qualitative and fluffy in nature to make more of an ROI approach and I would welcome if you could sort of mention in your work that its not only about the brand valuation that is being put up at once but reflect on the fact that for most clients its actually very important to not only have a one time valuation but a long term tracking tool and to have a continued long term tool to actually manage and track the brand value.

CB – Thank you.

Conversation ends.



APPENDIX L. TECHNICAL SUMMARY – IFRS 3 BUSINESS COMBINATIONS

Technical Summary



This extract has been prepared by IASC Foundation staff and has not been approved by the IASB. For the requirements reference must be made to International Financial Reporting Standards.

IFRS 3 *Business Combinations*

The objective of this IFRS is to specify the financial reporting by an entity when it undertakes a *business combination*.

A business combination is the bringing together of separate entities or businesses into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquiree. If an entity obtains control of one or more other entities that are not businesses, the bringing together of those entities is not a business combination.

This IFRS:

- (a) requires all business combinations within its scope to be accounted for by applying the purchase method.
- (b) requires an acquirer to be identified for every business combination within its scope. The acquirer is the combining entity that obtains control of the other combining entities or businesses.
- (c) requires an acquirer to measure the cost of a business combination as the aggregate of: the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree; plus any costs directly attributable to the combination.
- (d) requires an acquirer to recognise separately, at the acquisition date, the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the following recognition criteria at that date, regardless of whether they had been previously recognised in the acquiree's financial statements:



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- (i) in the case of an asset other than an intangible asset, it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably;
- (ii) in the case of a liability other than a contingent liability, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and its fair value can be measured reliably; and
- (iii) in the case of an intangible asset or a contingent liability, its fair value can be measured reliably.
- (e) requires the identifiable assets, liabilities and contingent liabilities that satisfy the above recognition criteria to be measured initially by the acquirer at their fair values at the acquisition date, irrespective of the extent of any minority interest.
- (f) requires goodwill acquired in a business combination to be recognised by the acquirer as an asset from the acquisition date, initially measured as the excess of the cost of the business combination over the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities recognised in accordance with (d) above.
- (g) prohibits the amortisation of goodwill acquired in a business combination and instead requires the goodwill to be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired, in accordance with IAS 36 *Impairment of Assets*.
- (h) requires the acquirer to reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the business combination if the acquirer's interest in the net fair value of the items recognised in accordance with (d) above exceeds the cost of the combination. Any excess remaining after that reassessment must be recognised by the acquirer immediately in profit or loss.
- (i) requires disclosure of information that enables users of an entity's financial statements to evaluate the nature and financial effect of:
- (i) business combinations that were effected during the period;
 - (ii) business combinations that were effected after the balance sheet date but before the financial statements are authorised for issue; and
 - (iii) some business combinations that were effected in previous periods.



(j) requires disclosure of information that enables users of an entity's financial statements to evaluate changes in the carrying amount of goodwill during the period.

A business combination may involve more than one exchange transaction, for example when it occurs in stages by successive share purchases. If so, each exchange transaction shall be treated separately by the acquirer, using the cost of the transaction and fair value information at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction. This results in a step-by-step comparison of the cost of the individual investments with the acquirer's interest in the fair values of the acquiree's identifiable assets, liabilities and contingent liabilities at each step.

If the initial accounting for a business combination can be determined only provisionally by the end of the period in which the combination is effected because either the fair values to be assigned to the acquiree's identifiable assets, liabilities or contingent liabilities or the cost of the combination can be determined only provisionally, the acquirer shall account for the combination using those provisional values. The acquirer shall recognise any adjustments to those provisional values as a result of completing the initial accounting:

- (a) within twelve months of the acquisition date; and
- (b) from the acquisition date.